Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1977.

No. 77-80

HOWARD POLIN,

Petitioner,

v.

CONDUCTRON CORPORATION, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Petitioner Howard Polin, plaintiff below, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in this matter on March 23, 1977, and the *per curiam* Order of the Court of Appeals denying plaintiff's petition for rehearing, entered on April 14, 1977.

OPINIONS BELOW.

The March 23, 1977 opinion of the Court of Appeals is reported at 552 F. 2d 797 and appears in the Appendix at A1-A40. The *per curiam* Order of the Court of Appeals denying plaintiff's petition for rehearing is unreported and appears in the Appendix at A41. The pre-trial Opinion and Orders of the United States District Court for the Eastern District of Missouri dated January 23, 1973, dismissing plaintiff's claims under Sections 14 and 10(b) of the Securities Exchange Act of 1934 without trial, are unreported and appear in the Appendix at A42-A49. The post-trial Opinion of the District Court dated January 23, 1976, dismissing plaintiff's remaining claims after trial, is reported at 411 F. Supp. 698 and appears in the Appendix at A50-A61.

JURISDICTION.

The judgment of the Court of Appeals was entered on March 23, 1977. A timely petition for rehearing was denied on April 14, 1977. The statutory provision which confers jurisdiction on this Court to review the judgment of the Court of Appeals by writ of certiorari is 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

Plaintiff alleged that defendants had issued a false, misleading, and incomplete consent statement to minority shareholders, soliciting consents to a merger, in violation of Sections 14(a) and 10(b) of the Securities Exchange Act of 1934. The District Court dismissed this claim without a trial, reasoning that defendants could have effected the merger without any minority votes being cast in favor of the merger. The Court of Appeals affirmed without reaching this question, holding that it was unnecessary to decide whether or not the consent statement was false, misleading, and incomplete, because the terms of the merger were "fair." Therefore, the questions presented for review are:

1. Should a minority shareholder be deprived of any remedy for a violation of the "full disclosure" requirements of the Securities Exchange Act of 1934, solely because of an after-the-fact judicial determination that the terms of a merger were "fair"?

2. Where proponents of a merger are required by federal law to solicit consents from minority shareholders, may they nevertheless ignore the "full disclosure" requirements of the Securities Exchange Act of 1934 merely because such proponents own a controlling majority of the stock of the company being acquired?

RELEVANT STATUTES AND REGULATIONS.

Section 14(a) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U. S. C. § 78n(a), provides as follows:

> "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title."

Rule 14a-9(a), 17 C. F. R. § 240.14a-9(a), promulgated by the Securities and Exchange Commission ("SEC") under Section 14(a) of the 1934 Act, provides as follows:

> "(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

Section 10(b) of the 1934 Act, 15 U. S. C. § 78j(b), provides as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C. F. R. § 240.10b-5, promulgated by the SEC under Section 10(b) of the 1934 Act, provides as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(a) to employ any device, scheme, or artifice to defraud,

"(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

"in connection with the purchase or sale of any security."

STATEMENT OF THE CASE.

This petition seeks review of a decision which holds that minority shareholders of a corporation which goes private are not entitled to the "full and fair disclosure" [1] mandated by the Securities Exchange Act of 1934 where the terms of the merger are "fair."

The present case arises out of the 1971 merger of Conductron Corporation ("Conductron") into a wholly-owned subsidiary of McDonnell Douglas Corporation ("McDonnell"). Prior to 1971, McDonnell owned 80.5 percent of Conductron's stock, with public shareholders (including plaintiff) holding the remaining 19.5 percent. In 1971, pursuant to the requirements of Section 14 of the Securities Exchange Act of 1934, Conductron issued a Consent Statement to its public shareholders, soliciting their consents to a merger of Conductron into McDonnell Douglas Electronics Company ("MDEC"), a newly formed Delaware corporation, which was wholly-owned by McDonnell. Under the terms of the proposed merger, each public shareholder of Conductron would receive 0.27 shares of McDonnell stock for each share of Conductron stock then held; Conductron's assets would be transferred to MDEC; and Conductron's separate corporate existence would be terminated. Under Delaware law, dissenting shareholders were not entitled to appraisal rights.

Plaintiff moved unsuccessfully to enjoin the proposed merger, and later amended his complaint to seek damages or rescission of the merger contending, *inter alia*, that Conductron's Consent Statement was false, misleading, and incomplete on several material points, in violation of Sections 14(a) and 10(b) of the Securities Exchange Act

1. *Santa Fe Industries, Inc. v. Green*, 45 U. S. L. W. 4317, 4321 (March 23, 1977).

of 1934 and SEC Rules 14a-9 and 10b-5.[2] Jurisdiction was based on Section 27 of the 1934 Act, 15 U. S. C. § 78aa. Plaintiff contended that the Consent Statement affirmatively misrepresented Conductron's financial situation and, in addition, failed to disclose that:

> (a) Conductron, which had lost more than $54,000,000 on the manufacture of aircraft flight simulators between 1966 and 1971, had decided to discontinue that business, and was projecting profitable operations for all future periods;
>
> (b) McDonnell, by implementing the proposed merger, would realize federal and state income tax savings in excess of $11,000,000, which savings would not be available to it if Conductron retained its independent corporate existence; and
>
> (c) the sole reason advanced for the merger—Conductron's alleged need for continuation of "loans" from McDonnell—was based upon a false premise, since McDonnell's advances to its subsidiary, Conductron, were actually capital contributions, and unenforceable as loans.

The District Court dismissed plaintiff's federal law disclosure claims relating to the accuracy of the Consent Statement on a motion to dismiss, reasoning that the Consent Statement did not "cause" the merger, since McDonnell already owned sufficient shares of Conductron stock to secure approval of the merger without regard to the votes of the minority shareholders (App. A43 and A48). Thus, while a trial was held thereafter with respect to plaintiff's state law claims relating to the terms of the merger and other claims unrelated to the merger (none of

2. 15 U. S. C. §§ 78n(a), 78j(b); 17 C. F. R. §§ 240.14a-9, 240.10b-5. The solicitation of written consents, like the solicitation of proxies, is governed by Section 14(a) and Rule 14a-9.

which is involved in the present petition), the federal claims relating to the accuracy of the 1971 Consent Statement were never tried.

The Court of Appeals also refused to pass on plaintiff's federal disclosure claims on the grounds that, whether or not the Consent Statement was accurate or "caused" the merger, the merger was "fair" under state law, and therefore, the public shareholders were not damaged (App. A27-A40). In so ruling, the Court of Appeals completely ignored plaintiff's demand for rescission of the merger.

Petitioner respectfully submits that the effect of the decisons below is to repeal the "full and fair disclosure" requirements of the Securities Exchange Act of 1934 in the context of mergers between parents and subsidiaries, in plain contravention of the requirements of both that Act and of the controlling decisions of this Court. Review by this Court is therefore required to assure the continued protection of minority shareholders under the federal securities laws and to preserve the integrity of those laws.

REASONS FOR GRANTING THE WRIT.

A. The Decision Below Is Contrary to Prior Decisions of This Court and of the Third Circuit Because It Deprives Minority Shareholders of Any Remedy for a Disclosure Violation Solely on the Basis of a Determination That the Terms of the Underlying Merger Were Fair.

The objective of the Securities Exchange Act of 1934, as repeatedly declared in this Court's decisions under that Act, "is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure." *J. I. Case Co. v. Borak*, 377 U. S. 426, 431 (1964). Only a few months ago, this Court reaffirmed in *Santa Fe Industries, Inc. v. Green*, 45 U. S. L. W. 4317, 4321 (March 23, 1977), that the objective of the 1934 Act is "full and fair disclosure." Thus, to be deprived of such full, advance disclosure of material facts is to be stripped of the very protections guaranteed by the 1934 Act. Because of the primacy of the full disclosure mandate, "Use of a solicitation that is materially misleading is itself a violation of law. . . ." *Mills v. Electric Auto-Lite Co.*, 396 U. S. 375, 381-383 (1970). As this Court further recognized in *Mills*, a *post hoc* judicial evaluation of the *fairness* of the terms of a merger is no remedy for a *disclosure* violation, and indeed relates to an inquiry foreign to the concerns of the federal law:

> *"The decision below, by permitting all liability to be foreclosed on the basis of a finding that the merger was fair, would allow the stockholders to be bypassed,* at least where the only legal challenge to the merger is a suit for retrospective relief after the meeting has been held. *A judicial appraisal of the merger's merits could be substituted for the actual and informed vote of the stockholders.*

> *"The result would be to insulate from private redress an entire category of proxy violations—those relating to matters other than the terms of the merger.* Even outrageous misrepresentations in a proxy solicitation, if they did not relate to the terms of the transaction, would give rise to no cause of action under § 14(a). Particularly if carried over to enforcement actions by the Securities and Exchange Commission itself, such a result would subvert the congressional purpose of ensuring full and fair disclosure to shareholders.
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> ° ° °
>
> "Such a frustration of the congressional policy is not required by anything in the wording of the statute or in our opinion in the Borak case. Section 14(a) declares it 'unlawful' to solicit proxies in contravention of Commission rules, and SEC Rule 14a-9 prohibits solicitations 'containing any statement which . . . is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading . . . .' *Use of a solicitation that is materially misleading is itself a violation of law,* as the Court of Appeals recognized in stating that injunctive relief would be available to remedy such a defect if sought prior to the stockholders' meeting." (Emphasis added.)[3]

Because "full and fair disclosure" is the essence of the protections secured to minority shareholders by the federal securities laws, the reliance of the Court of Appeals herein on the fairness of the terms of the Conductron

3. In the present case, plaintiff sought an injunction prior to the 1971 merger but it was denied on the grounds that Conductron was allegedly "near the brink of financial collapse." (App. 31 n. 57).

MDEC merger to justify dismissal of plaintiff's federal claims was plain error, not only under *Mills*, but also under this Court's very recent decision in *Santa Fe Industries, Inc. v. Green, supra.*[4]

In *Santa Fe*, the Second Circuit had held that the merger involved therein violated Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder because it was "unfair" to minority shareholders. This Court reversed, since it was conceded that the underlying proxy materials were not false and misleading, and held (45 U. S. L. W. at 4321) that:

> "[T]he Court repeatedly has described the 'fundamental purpose' of the [1934] Act as implementing a 'philosophy of full disclosure'; *once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute. Cf. Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 381-385 (1970)." (Emphasis added).

In the present case, the Court of Appeals has stood Section 10(b) and Rule 10b-5 on their heads, by relying on the "fairness" of the terms of the merger under state law to justify lack of full and fair disclosure under federal law. Contrary to both *Mills* and *Santa Fe*, the Court of Appeals in the decision below ignored the "full disclosure" which is the "fundamental philosophy" of the 1934 Act, in favor of what this Court has described as "at most a tangential concern of the statute."

Moreover, the effect of the Court of Appeals decision here, taken together with this Court's decision in *Santa Fe*, is to deprive the minority shareholders of Conductron of *any* remedy whatsoever since: (1) the minority shareholders of Conductron, unlike the minority shareholders in

4. The *Santa Fe* decision was not available to the Court of Appeals below, because it was announced by this Court on the same day that the Court of Appeals delivered its opinion herein.

the *Santa Fe* case, had no appraisal remedy under Delaware law; (2) the minority shareholders of Conductron have never had their day in court with respect to their claim that the 1971 Consent Statement was false, misleading, and incomplete; and (3) under *Santa Fe*, the Court of Appeals should not even have inquired into the fairness of the McDonnell-Conductron merger in ruling on plaintiff's federal disclosure claims.

The decision of the Court of Appeals below is also in conflict with the decision of the Third Circuit in *Kohn v. American Metal Climax, Inc.*, 458 F. 2d 255, 270 (3d Cir. 1972), *cert. denied*, 409 U. S. 874 (1972).[5] There, the court affirmed the grant of rescissionary relief against a merger accomplished with the use of false and misleading proxy materials, even though the fairness of the terms of the merger was unreviewable because of a prior and binding determination of a Zambian court that the merger was fair.[6]

In sum, the decision of the Court of Appeals herein is contrary to a long and consistent line of cases in this Court, starting with *Borak* and continuing through *Santa Fe*, and is in conflict with the decision of the Third Circuit in *Kohn*. It should not be permitted to stand unreviewed by this Court.

5. The *Kohn* decision is particularly noteworthy herein, since the present case was originally filed in the Eastern District of Pennsylvania, in the Third Circuit, but was transferred under 28 U. S. C. § 1404(a) to the Eastern District of Missouri.

6. In *Kohn*, the District Court found that rescission itself was no longer feasible and ordered instead that the minority shareholders be offered equity participation in a subsidiary of the defendant which had received most of the assets of the former corporation. 458 F. 2d at 270. Similarly, if the lower courts were to conclude that rescission of the McDonnell-Conductron merger were no longer feasible, they could order that Conductron's former minority shareholders be offered equity participation in McDonnell Douglas Electronics Co. or Actron Industries, Inc., which received most of the former Conductron assets.

B. The District Court's Holding on the Issue of Causation, Not Reached by the Court of Appeals, Is in Conflict With Decisions in the Second Circuit, on a Point Left Open by This Court in *Mills v. Electric Auto-Lite Co.*

The basis for the District Court's pretrial dismissal of plaintiff's claims under Sections 14(a) and 10(b) was that "the causal relationship required under sections 10(b) and 14(a) was lacking" because McDonnell owned 80 percent of Conductron's stock and "could have effectuated the merger without minority approval." (App. A30 n. 55). Although the Court of Appeals did not reach this issue, it correctly noted that:

> "The court relied on *Mills v. Electric Auto-Lite Co.*, 396 U. S. 375, 385 (1970), however footnote 7 of *Mills* left open the issue before us." (App. A30 n. 55)

Footnote 7 in *Mills*, 396 U. S. at 385 n. 7, reads as follows:

> "We need not decide in this case whether causation could be shown where the management controls a sufficient number of shares to approve the transaction without any votes from the minority. Even in that situation, if the management finds it necessary for legal or practical reasons to solicit proxies from minority shareholders, at least one court has held that the proxy solicitation might be sufficiently related to the merger to satisfy the causation requirement, see Laurenzano v. Einbender, 264 F. Supp. 356 (DC ED NY 1966); cf. Swanson v. American Consumer Industries, Inc., 415 F. 2d 1326, 1331-1332 (CA 7th Cir. 1969); Eagle v. Horvath, 241 F. Supp. 341, 344 (DC SD NY 1965); Globus, Inc. v. Jaroff, 271 F. Supp. 378, 381 (DC SD NY 1967); Comment, Shareholders' Derivative Suit to Enforce a Corporate Right of Action Against Directors Under SEC Rule 10b-5, 114 U. Pa. L. Rev. 578, 582 (1966). But see Hoover v. Allen, 241 F. Supp. 213, 231-232 (DC SD NY 1965); Barnett v. Anaconda Co., 238 F. Supp. 766, 770-774 (DC SD NY 1965); Robbins v. Banner Industries, Inc., 285 F. Supp. 758, 762-763 (DC SD NY 1966). See generally 5 L. Loss, Securities Regulation 2933-2938 (Supp. 1969)."

Since *Mills*, the Second Circuit has decided that even where management controls a majority of a corporation's voting stock, the causation requirement is nevertheless met so long as "management finds it necessary for legal or practical reasons to solicit proxies from minority shareholders." The Second Circuit so held in both *Laurenzano v. Einbender*, 448 F. 2d 1, 5 (1971) (affirming the district court decision cited in the *Mills* footnote) and in *Schlick v. Penn-Dixie Cement Corp.*, 507 F. 2d 374 (1974), *cert. denied* 421 U. S. 976 (1975).

The Second Circuit rule vindicates the 1934 Act's mandate for full and fair disclosure, and should be adopted by this Court. As the Second Circuit aptly stated in *Schlick* (507 F. 2d at 384):

> "By virtue of the [true] disclosure either modification or reconsideration of the terms of the merger by those in control might be effectuated. We cannot assume that even a rapacious controlling management would necessarily want to hang its dirty linen out on the line and thereby expose itself to suit or Securities Commission or other action—in terms of reputation and future takeovers."

In terms of the present case, McDonnell might very well have been unwilling to proceed with the merger if

full and accurate disclosure had been required of it, particularly in light of the substantial tax benefits which it received by virtue of the merger, and which were not disclosed to the public shareholders. Accordingly, where full and fair disclosure has not been made, and the shareholders have been denied their rights under federal law, relief should not be denied simply because the violator owns a controlling block of the soliciting corporation's stock.

CONCLUSION.

For the foregoing reasons, petitioner respectfully prays that this Honorable Court issue a writ of certiorari (a) to review the judgment of the Court of Appeals for the Eighth Circuit, or (b) to vacate the Judgment of the Court of Appeals, and remand this case to the Court of Appeals for reconsideration in light of this Court's decision in *Santa Fe Industries, Inc. v. Green*.

Respectfully submitted,

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Dated: July 13, 1977.

CERTIFICATE OF SERVICE.

I hereby certify that three copies of this Petition were served by First Class Mail, postage prepaid, on each of the following attorneys on July 13, 1977:

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I further certify that all parties required to be served have been served.

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Appendix.

COURT OF APPEALS OPINION.

UNITED STATES COURT OF APPEALS
EIGHTH CIRCUIT.

No. 76-1207.

HOWARD POLIN, etc., et al., Appellants,

v.

CONDUCTRON CORPORATION et al., Appellees.

Decided March 23, 1977.

Before GIBSON, *Chief Judge*, BRIGHT, *Circuit Judge*, and TALBOT SMITH,* *Senior District Judge*.

TALBOT SMITH, *Senior District Judge*.

This is an action brought by plaintiff Howard Polin, a shareholder of Conductron Corporation (hereafter Conductron), charging defendants with violations of the federal securities laws and breach of their fiduciary duties.[1]

* TALBOT SMITH, Senior District Judge, Eastern District of Michigan, sitting by designation.

1. The instant litigation commenced in 1969 when plaintiff filed his complaint in the United States District Court for the Eastern District of Pennsylvania. In 1971, plaintiff filed a second suit in the Eastern District of Pennsylvania against several of the same defendants. In 1972, Judge Higginbotham ordered both suits transferred to the Eastern District of Missouri. The two suits were then ordered consolidated into one action for all purposes, and plaintiff, by leave of court was permitted to file a consolidated amended complaint.

Jurisdiction is predicated on section 27 of the Securities Exchange Act of 1934, 15 U. S. C. § 78aa, diversity, and pendent jurisdiction.

Named as defendants are Conductron, McDonnell Douglas Corp. (MDC) and several officers and directors of Conductron and MDC. Plaintiff asserts both individual and derivative claims. Additionally, plaintiff seeks to maintain his individual claims as the representative of the class of similarly situated stockholders of Conductron.

Prior to trial, the District Court [2] refused to certify plaintiff's individual claims as class actions. After trial by the Court, judgment on the merits was entered for defendants. *Polin v. Conductron Corp.*, 411 F. Supp. 698 (E. D. Mo. 1976). We affirm.

Conductron was incorporated in Delaware in November, 1960. Initially, Keeve M. Siegel held 80 per cent of its stock and Paramount Pictures the other 20 per cent. Siegel, who had been a Professor of Electrical Engineering at the University of Michigan and the director of the University's Radiation Laboratory, became Conductron's President and, in 1961, Chairman of the Board.

Conductron, the bulk of whose facilities were in Ann Arbor, Michigan, was engaged in electronics research and development. The major part of Conductron's business, until 1966, was with the United States Government and its contractors.

By 1964, Conductron scientists and engineers had made several advances, particularly in radar. Conductron, however, lacked the large scale production facilities needed to obtain government production contracts. In the spring of 1964, Conductron entered into negotiations with McDonnell Aircraft Corp. (MDC [3]), which had only a few months earlier purchased Paramount's Conductron stock,

2. The Honorable John K. Regan, United States District Judge for the Eastern District of Missouri.

3. After merging with Douglas Aircraft Co., McDonnell Aircraft changed its name to McDonnell Douglas Corp. We will use "MDC" to refer to McDonnell Aircraft Corp. and all successor corporations, including McDonnell Douglas.

for the acquisition of additional production facilities. An agreement was signed on January 7, 1966. According to the agreement, MDC would receive 1,850,000 newly issued shares of Conductron stock, giving it over 80 per cent of Conductron's outstanding stock. Conductron would receive all of the business and assets of MDC's Electronic Equipment Division (EED), all of the capital stock of Tridea Electronics Co., a wholly-owned subsidiary of MDC, and $5,000,000 in cash. A notice of a special shareholders' meeting, proxy material, and a letter from Siegel recommending approval of the transaction were sent to Conductron's shareholders. The Conductron shareholders voted to approve the transaction, which was closed on January 27, 1966.

Approximately a year later, on January 30, 1967, the Executive Committee of Conductron voted to acquire the assets subject to liabilities of Advanced Communications, Inc. (ACI) in exchange for 3,482 shares of Conductron stock. As additional consideration for the purchase, Conductron assumed a $300,000 note, then owing by ACI. Forty-six per cent of ACI's stock had been owned by MDC. The Conductron acquisition of ACI was consummated on February 25, 1967.

At the same meeting, Conductron's Executive Committee decided to reject a proposal that Conductron acquire Hoffman Products Co., a manufacturer of radios, televisions, and stereo equipment for Montgomery Ward, and Hoffman Electronics Co. The Hoffman acquisition had been negotiated by Siegel, who had continued as Chairman of the Board and President of Conductron after MDC's acquisition of 80 per cent of Conductron's stock. Siegel favored Conductron's acquisition of Hoffman, but was opposed to the ACI acquisition. However, he was outvoted 2-1 in Conductron's Executive Committee.

Siegel then resigned from all of his positions with Conductron, and disposed of all of his Conductron stock during February, 1967.[4]

Siegel's responsibilities were assumed on a temporary basis by R. A. Olsen, Vice President of Conductron, who was given the additional title, "Acting General Manager." On April 27, 1967, Walter F. Burke, a director and officer of MDC was elected President of Conductron. Olsen disposed of his Conductron stock in July, 1967. He left Conductron on October 21, 1967 and immediately became an officer and director of K. M. S. Industries, Inc., in which he had invested the proceeds from the sale of his Conductron stock.

Conductron was eventually merged into McDonnell Douglas Electronics Co. (MDEC) and its separate corporate existence terminated. This merger as well has been the subject of attack and will be considered by us *infra*.

Originally, two suits were filed respecting different aspects of Polin's claims. Both were transferred to the Eastern District of Missouri and, by order of the Court, consolidated into one action. Thereafter, as we have noted, plaintiff filed a consolidated amended complaint covering both actions. The consolidated amended complaint contained five counts. Counts I and II, resolved adversely to plaintiff at trial, have not been pursued in this Court.

In Count III of plaintiff's consolidated amended complaint, he brought an individual and class action under §§ 10(b) and 14(a) of the Securities Exchange Act of

4. Siegel invested over two million dollars of the proceeds from the sale of his Conductron stock in K. M. S. Industries, Inc., which he founded shortly after his departure from Conductron.

1934 (1934 Act) and Rules 10b-5 and 14a-9 thereunder,[5] for damages allegedly suffered by plaintiff and "all other similarly situated shareholders of Conductron" as a result

5. Section 10 of the 1934 Act, 15 U. S. C. § 78j, provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10-b-5, 17 C. F. R. § 240.10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 14(a) of the 1934 Act, 15 U. S. C. § 78n(a), provides:

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section [12] of this title.

Securities and Exchange Commission Rule 14a-9, 17 C. F. R. § 240.14a-9 provides, in relevant part:

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing

of their purchases of Conductron stock between 1966 and 1969. The plaintiff twice moved to have this count certified as a class action, the District Court rejecting both motions.

The first motion was submitted after extensive discovery with respect to the class action issue, the submission of briefs and oral argument thereon.[6] The court denied class action certification, pointing out that the

5. (Cont'd.)
any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

• • •

NOTE: The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this rule:

(a) Predictions as to specific future market values, earnings, or dividends.

(b) Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.

On this appeal, plaintiff has, with respect to Count III, placed sole reliance upon § 10(b) of the 1934 Act and Rule 10b-5 thereunder.

6. A renewed motion was filed on April 29, 1974, with trial then set for May 6, 1974, having been so set on January 4, 1974. Trial was then passed for a week "to accommodate plaintiff's counsel" and the renewed motion denied on the ground of untimely filing, "further delay [in] the trial for a protracted period," and finally on the ground that "our original ruling was correct and should not be modified."

charges made related to allegedly false and misleading statements in proxy statements, financial statements, Annual Reports and other documents allegedly relied upon by purchasers of Conductron stock in the years of 1966, 1967, 1968, and 1969, that the number of such purchasers was estimated to be in excess of 2600, that the purchase dates of the various buyers would be of importance in determining the rights of each purchaser,[7] that 1966 buyers could not have been influenced by the alleged 1967, 1968 or 1969 false representations, and that the facts common to purchasers "in the various years do not, under the present record, predominate."[8] It was the court's final conclusion that the factual issues were "too diverse to warrant class treatment."[9] Moreover, it was clear on the record, that plaintiff had, throughout the years, while charging various malfeasances and misfeasances against the defendants, continuously purchased Conductron stock himself, despite the gravity of the charges made, thereby raising the most serious questions as to whether or not he was a proper "representative" of the allegedly injured class.[10] The Court's conclusion on all of this was "that the claim would be completely unmanageable if it were sustained as a class action."[11]

It is well settled that the trial court has broad discretion in determining whether a class action may be maintained and its determination should be given great weight by a reviewing court. *Wright v. Stone Container Corp.*,

7. Plaintiff asserted, *inter alia*, that the price of Conductron stock was artificially inflated as a result of the totality of misleading statements.

8. District Court Memorandum, unreported App. 219-20.

9. *See* Fed. R. Civ. P. 23(b)(3).

10. *See* Fed. R. Civ. P. 23(a)(4).

11. The rationale of the Court's holding with respect to the class action aspects of Count III, was properly held by the Court to be equally applicable to Counts IV and V, discussed *infra*.

524 F. 2d 1058, 1061 (8th Cir. 1975); 3B *Moore's Federal Practice* ¶ 23.50.[12]

We are satisfied that the court has carefully weighed the controlling factors and we are unpersuaded that there has been any abuse of discretion in the subject rulings.

It is the claim of the plaintiff that the January, 1966 proxy statement, the 1965 Annual Report, as well as the First 1966 Annual Report, the Second 1966 Annual Report, the 1967 Annual Report, the Press Release of May 3, 1968, and the 1968 Annual Report, all contained false and misleading statements, "particularly with reference to Conductron's aircraft simulator business ° ° °."

In order to analyze properly the frauds allegedly practiced almost throughout Conductron's entire corporate life, it is necessary to acquire some perspective as to the simulator business, its origins, its prospects, and its costs, since all are comprehended, in one form or another, in fraud charges covering the years in question.

The simulator, as the name implies, simulates something else. With respect to aircraft, the simulator duplicates ("simulates") the cockpit of the plane. Through an intricate system of wiring and programming, and with the aid of computers, aircraft operating characteristics may be simulated for various situations, both routine and of serious nature. The entire plane performance is duplicated, from take-off, through systems performance, radio navigation and communication, descent, approach and ground operations. The savings accomplished through the

12. *See also City of New York v. International Pipe and Ceramics Corp.*, 410 F. 2d 295, 300 (2d Cir. 1969):

> In final analysis, resolution of the question now presented [class action certification] reverts to the "fair and efficient adjudication" problem. The trial judge will have to face this problem in a realistic way. He should be afforded the greatest latitude in the exercise of his judgment after a careful factual exploration as to how this result can be attained.

use of a simulator are of substantial magnitude. The airplane being simulated, costing from $5,000,000 to $25,000,000 is released for other operations by a simulator costing from $1,000,000 to $2,000,000. Moreover, there is no danger during training to the fledgling pilot or his airplane. The training, in fact, is so detailed that after the simulator work is completed, only "one final flight in the airplane [is required] before they [the pilots] had to fly passengers ° ° °."[13]

But the problems involved in simulator manufacture parallel in complexity the operations of the machine itself, since the design, engineering, and manufacture require from two to five years. Since the simulator must match exactly the airplane it is intended to simulate, plane changes require simulator changes, and even between planes of the same general design, such as the Boeing 737, to simulate one is not to simulate all. In addition, different airplanes flying the same plane may order different cockpit configurations, as changes are made in equipment, causing unanticipated and substantial losses, arising not only from production design costs but also from changes in the hardware that goes into the simulator cockpit.

The simulator engineers with the Electronic Equipment Division (EED) of MDC did not come to Conductron as novices.[14] As Mr. Toole, then an employee of EED put it, "My feelings were that we had a technical break-through in simulation, one that was worth pursuing as a new line of business. One that had a great deal of potential with the airlines and with the military." The new line of business was anticipated to be profitable, not only because of a large upswing in the purchases of air-

13. Testimony of Mr. Toole, Project Manager Trainers and Simulators, Conductron Corp.

14. We note that EED had designed simulators for the Mercury and Gemini spacecraft.

craft, but because EED's advanced technology made the competition "rather minimal, in that no large companies who you might say had huge resources behind them were involved." [15] But the roseate future envisioned did not materialize. In fact, the operation foundered.

MDC, through the EED division, obtained contracts for one 737 simulator from Boeing in September, 1965 and for two more 737 simulators from United Airlines the following month. "Everybody was pretty pleased," testified Mr. McDonnell, Chairman of the MDC Board, in his deposition. In January of 1966 Conductron acquired EED. The contracts for the three 737 simulators were transferred from EED to Conductron, MDC promised Conductron continued business, paid $5,000,000 as part of the agreements, and promised substantial grants for research.[16] It is significant that all parties here recognized the need for additional funds for this purpose.

Increased aircraft purchases were made by the airlines in September of 1966,[17] Conductron felt that its technology would be of great interest to the lines "and it was apparent to us that we would make a lot of sales." [18]

15. Testimony of Mr. Murray, Executive Vice-President, MDC, and director of Conductron, 1966-1971.

16. In 1964, MDC purchased 20 per cent of the outstanding common stock of Conductron Corporation of Ann Arbor, an electronics research and development firm.

The January 7, 1966 agreement between MDC and Conductron provided that MDC would acquire 1,850,000 newly issued shares of Conductron stock in return for all the business and assets of EED, all the capital stock of Tridea Electronics Company, and $5,000,000 cash.

The agreement gave MDC slightly more than 80 per cent of the outstanding stock of Conductron.

Notice of a shareholders meeting on January 25, 1966 and a proxy statement, together with a letter from Mr. Siegel, President of Conductron, were sent to Conductron shareholders concerning the proposed transaction.

17. Testimony of Mr. Toole.

18. *Id.*

But Conductron anticipated achieving a substantial "commonality" [19] among the same aircraft. This did not result. The aircraft (Boeing 737) was itself changed, cockpits were altered, each airline in effect wanted its own simulator with the result that substantial losses were suffered by Conductron. In addition, "competitions were quite vicious," [20] with the result that prices were steadily driven down. Other factors contributed, and in substance, the aircraft market dried up.[21] In addition, special problems developed with the C-5A military aircraft simulator which Conductron was building for Lockheed. [22]

19. In general the term refers to a fundamental similarity of design, with only minor variations, applicable to different planes.

20. Testimony of Mr. Murray.

21. Mr. Braun, now Vice-President of McDonnell Aircraft Co. and General Manager of the F-15 Program, joined Conductron in January of 1966. His testimony as to the decline in business reflects the difficulties faced by the corporation. As to the airlines' needs as the years went on in 1968, 1969 and 1970:

> Well, as the years went on there, why, the airlines' business declined considerably. The number of new aircraft that they were placing on order dropped off rather drastically and the net result was that the airlines suddenly discovered that they had more aircraft than they knew what to do with. In other words, airplanes were being tied down for lack of use. So there was a trend at that time to move back away from purchasing simulators and instead use that extra aircraft capacity which they had to do their training. And then this problem, of course, was compounded from our standpoint with the 737, due to the fact that Boeing's projections as far as 737 sales were particularly off. The 737 did not, in fact, turn out to be as competitive an aircraft as Boeing had hoped. In fact, the 737 is the only commercial airliner I believe that Boeing has built that actually lost money up to the present time. So unfortunately, again, we were tied in with an airplane there that didn't turn out as well as it was hoped.

22. The C-5A simulator contract was a fixed price-incentive contract, allowing the contractor to recover its costs but only up to a specified maximum. Conductron's cost substantially exceeded the maximum, as a result, in large measure, of the many design changes which were made in the C-5A by Lockheed after work had begun on the simulator.

We turn to the matter of costs and the reporting thereof. Obviously, the research and development costs could not be borne by the first model produced. The cost assigned to any unit [23] depended upon the competitive market, cost estimates, and the number of the model to be produced. It is clear that at this point an accounting and disclosure problem is presented.

Conductron made its agreement with MDC for acquisition of EED on January 7, 1966. It is with respect to the representations made, and omitted, in the proxy statement issued in connection therewith that plaintiff's initial charges of misrepresentation arise. The plaintiff's principal challenge is that the proxy statement did not disclose the anticipated losses in the simulator business. The short answer, on the record, is that defendants anticipated substantial profits, not losses. It is true that defendants' roseate economic anticipations were doomed, but economic prognostication, though faulty, does not, without more, amount to fraud. Moreover, the proxy statement gave fair warning that the development and other start-up costs would depend for recovery upon future contracts. The information disclosed with reference thereto stated:

> The Division recently received contract awards from the Boeing Company and United Air Lines to design and build three 737 aircraft transport pilot training simulators for a total of $2,760,966. Expected additional contracts for the Boeing 737 simulators will be necessary to recover development and other start up costs.[24]

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23. The sales of commercial simulators were under fixed price contracts.

24. Appendix at 1516.

It could not reasonably be said that an investor of plaintiff Polin's experience [25] was unaware of the significance of this statement.[26]

But beyond the minutes of the various charges made and behind them as justification therefor, running through the entire series of reports, lies a fundamental accounting problem, namely, when and how Conductron should have written off the design and development costs of the simulator program. These costs were large and could not be charged in their entirety against the first simulators from a competitive standpoint. An amortization over the entire contract life was utilized.[27] If a sufficient number of simu-

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25. Mr. Polin has, for many years managed extensive stock portfolios. The net value at the time of the trial of his personal holdings was approximately $100,000. Mr. Polin also manages the portfolio of Bishop Processing Co., the net value of which was approximately $900,000 at the time of the trial. (The Polin family owns indirectly 49.7 per cent of the stock of Bishop Processing.)

Mr. Polin's and Bishop Processing's stock holdings run the gamut from the blue chips, such as Gulf and Western Industries, Inc., Appendix at 1137, to the stock of corporations which, like Conductron, are primarily engaged in developing new products through scientific research.

26. Cross-examination of Mr. Polin:

> Q And, sir, I take it that you know from your training and your business success that research and development is merely a first stage or first step in making a viable product that will ultimately generate a profit?
>
> A Yes, sir.
>
> Q That is the substance of what research and development is all about, isn't it?
>
> A Yes, sir.
>
> • • •
>
> Q You also knew, I take it, that it was possible that a company in research and development might strike out completely, didn't you?
>
> A On any one item, yes, sir.

27. Direct Examination of Mr. Toole, Project Manager for Trainers and Simulators at Conductron:

> MR. MANNINO: • • • I think it is important to determine at this point whether or not an amortization procedure as op-

lators are sold, amortization presents no problem. If not, due to economic conditions, lack of acceptance of the plane, or other cause, the manufacturer will suffer a loss. The point to be observed here is the fact that a disparity between expenditures and selling price of an early simulator does not result in a "loss." The Conductron Corporation followed a system of accounting employed under these circumstances by its accountants, Ernst & Ernst, under which initial non-recurring costs were allocated pro-rata over the life of the program, rather than being charged off in their entirety at the beginning of the program.

Plaintiff's complaints about the annual reports all revolve around the dates of the reporting of what plaintiff terms "anticipated simulator losses" and the accuracy of the accounting judgments made.[28] As to the latter, these

27. (Cont'd.)
posed to an instant write-off procedure was used on the simulators • • • .

• • •

THE WITNESS: Well, I was not in the financial side of our company, and I don't know exactly how this was handled from a financial standpoint, but my understanding was that we would spread the development cost over a quantity of simulators. The quantity was predicted based primarily on the number of aircraft that would be purchased. The airlines had a policy of buying one simulator for about every twenty airplanes they bought, and we could look at the aircraft market itself and predict the requirement for simulators at the various airlines.

• • •

Q Now, can you explain what Conductron did in order to recover development costs in its prices, if it did anything?

A This was what we were amortizing over the predicted market.

28. One of plaintiff's specific charges was that in its Annual Report for the six months ended June 30, 1966, "Conductron failed to charge off against income or otherwise disclose its anticipated multi-million dollar loss on the existing contracts for the three 737 simulators, instead charging off only $796,195 of the total antici-

are matters of judgment,[29] a judgment clearly dependent upon constantly changing factors.[30] It was in recognition

28. (Cont'd.)
pated loss." Brief for Appellant at 9. Mr. Schumer, a certified public accountant, testified that the $1.2 million after-tax loss written off in the Second Annual Report for 1966, covering the six months ending December 31, 1966, should have been written-off in the First Annual Report for 1966, issued on or about September 6, 1966, because "the same set of facts existed, same situation • • • ." However, Mr. Schumer's assertion that Conductron had the same degree of knowledge regarding losses on its simulator contracts at the time of the First Annual Report of 1966 as at the time of the Second Annual Report is far from convincing, and was contradicted by testimony which will be considered *infra*, at p. A16. Moreover, on cross-examination, Mr. Schumer testified that he had not examined the "commonality" which had been established as of June 30, 1966, as compared with that of December 31, 1966. Failure to achieve expected "commonality" would have an effect upon costs and hence upon anticipated losses.

Likewise, fraud is charged with respect to the 1967 Annual Report on the ground that "anticipated" losses had not, as the report stated, been charged off, and, further, that the report stated that the results for 1968 were "expected" to show improvement, and the Company saw a "possibility" of a break-even soon. The terms thus employed bespeak caution in outlook and fall far short of the assurances required for a finding of falsity and fraud. Language of expectation, of anticipation, and of possibilities recognizes the imponderable influences of complex variables in a fast-changing field.

29. Deposition testimony of Mr. Burke, President of Conductron during most of the 1967-70, and an officer and director of MDC during the time in question:

If you have a long-run program, it enables you to help even out the unit costs throughout the life of the program, and that's a factor, I didn't say it is a merit, it is a factor in making such a choice.

Another alternate is examining the market. If you are uncertain of the market, the more conservative approach, then, is to write off start-up and development costs in the earlier part of the contract so that while you have to pay a charge of higher cost per unit, your sales, if successful, will cover your start-up costs even for a short or small number of units.

There is no what I would call absolute standard for when you do which. It is very much a matter of judgment of the Management.

30. Direct examination of Mr. Braun:

Q Now, how was it decided at Conductron, if you know, what number of simulators of a particular line such as the 737

by Ernst & Ernst of such variables present in the operation being conducted that no provision for losses was made until the Second 1966 Annual Report, covering the period July 1—December 31, 1966. The Ernst & Ernst Report approving the financial statements in the Second 1966 Annual Report was dated March 17, 1967. Mr. Anderson, the Ernst & Ernst partner in charge of the Conductron auditing, testified that "I would think that there was significantly more information available in March of 1967 than there was in July of 1966," [31] this latter being the date of the Ernst & Ernst Report approving the financial statements in the First Annual Report for 1966. Such information required the recognition of certain losses at that time, but Ernst & Ernst cautioned the corporation about the difficulties inherent in making such judgments, stating, in part:

> [It] should be recognized that the estimate of losses referred to herein are subject to considerable revision as the contracts progress, based upon the demonstrated experiences to date.[32]

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30. (Cont'd.)

line it was necessary to sell in order to recover the non-recurring costs?

A Well, we knew or estimated if—wehadn't finished the work at that point in time. We knew—estimated then what the non-recurring costs were to be and we estimated, of course, what our recurring costs were going to be, and then amortized that non-recurring to the point where we could determine the break-even point and then from then on, the profit potential. So out of that we could determine precisely what number of simulators we had to sell to break even based on the estimate at that point in time.

Now, this was obviously a changing thing as time went on.

31. Appendix at 1378.

32. Letter of March 16, 1967 from Ernst & Ernst to the Board of Directors of Conductron.

The financial reports we examine were certified by Ernst & Ernst to be fair and accurate after substantial investigative research.[33] The Court found, moreover:

> [W]e have carefully reviewed each of these reports, as well as the earnings statements and the press releases, in light of plaintiff's complaints and find that none of them are fraudulently misleading either by omissions or by affirmative statements. It is true, of course, each report painted a gloomier picture of the extent of the losses incurred and anticipated than the preceding one, but there is no substantial basis for the contention that any of the reports withheld material information or fraudulently minimized losses which should have been anticipated.[34]

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33. The plaintiff has not joined Ernst & Ernst as a defendant, although much of plaintiff's case against the defendants turns upon the alleged failings of the accountants in their reporting of the financial affairs of Conductron. So far as any negligence on the part of Ernst & Ernst is concerned, plaintiff has not stated a claim. *See Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976) (private cause of action for damages will not lie under § 10(b) of the 1934 Act and Rule 10b-5 in the absence of any allegation af scienter-intent to deceive, manipulate or defraud).

34. *Polin v. Conductron Corp., supra*, 411 F. Supp. at 702.

Plaintiff's allegations that the court failed to make sufficient findings of fact are without merit. We addressed this issue in *United States ex rel. R. W. Vaught Co. v. F. D. Rich Co.*, 439 F. 2d 895, 898-99 (8th Cir. 1971), holding that:

> Appellant Rich asserts that the trial court failed to make the necessary findings to permit an adequate appellate review. Appellant specifically charges the findings relating to Vaught's alleged delay in performance were inadequate to sustain the trial court's conclusions of law. The trial judge made no separate findings, but instead incorporated them into his unreported memorandum opinion. Although the opinion does not elaborate or detail each subsidiary issue raised by defendant Rich in its claim for delay damages, the trial court clearly indicated the evidentiary basis for its decision on this issue.
>
> • • •
>
> Although more extensive findings are certainly helpful in a case as complex as this, the district court's memorandum

Under our review of this lengthy record we find no clear error of fact or misapplication of applicable law. There is no sustainable claim for damages or rescission.[35] What we had were, possibly, too-sanguine hopes for the future, as well as differences of opinion between accountants as to the complex problems of financial reporting of the new device, but the elements of fraud, the deceptions, the duplicities and the distortions normally concomitants of false and misleading statements, are completely missing.

In January of 1966, as heretofore noted, MDC and Conductron had agreed upon the acquisition by MDC of 1,850,000 shares of Conductron stock in return for the business and assets of MDC's Electronic Equipment Division, all of the capital stock of Tridea Electronics Company and a sum in cash. Tridea had owned a 46 per cent interest in Advanced Communications, Inc. (ACI), which interest had been retained by MDC at the time of the 1966 acquisitions. As time went on, however, it became apparent that ACI's technology was "too much for McDonnell Electronics' ability to manage" and "[i]t was * * * thought that putting ACI together with Conductron made a lot of sense" and would be beneficial to Conductron because of Conductron's technological and managerial capabilities. A difference of opinion developed among technical advisors as to the desirability of acquiring ACI. It was felt by some that despite its insolvency at that time,

34. (Cont'd.)
opinion sufficiently outlines the basis and underlying grounds for its decision, which is all that is required. [Cases cited.] Appellant Rich, who presented the trial court with 156 proposed findings, misconstrues the requirements of Rule 52(a), Fed. R. Civ. P. The trial court need not make specific findings on all facts and evidentiary matters brought before it, but need find only the ultimate facts necessary to reach a decision in the case. [Cases cited.]

35. As to the availability of a rescission remedy, we, of course, express no opinion in view of our holdings herein as to liability.

ACI's potential for future success was high, but by others that Conductron would be "acquiring a loss operation." The facts relating to both corporations were fully disclosed, with discussion thereof, though not with unanimity with respect thereto.

The matter came before the Executive Committee of Conductron on January 30, 1967. The proposal to acquire ACI, strongly recommended "on the engineering side," was approved by a vote of two to one.[36] The Board of Directors of ACI approved, with the absence noted in the record of A. C. Omberg, Vice President of MDC.[37] As a result of these and related corporate actions Conductron acquired 100 per cent of the assets of ACI, subject to its liabilities, in exchange for 3,482 shares (approximately .01% of Conductron's outstanding shares) of Conductron stock, and assumed a $300,000 note of ACI's. Subsequent to provisions for the $300,000 note, ACI's balance sheet showed a net worth of $154,361, for which Conductron paid $160,172 in its own shares.[38]

It is the claim of the plaintiff that MDC, as the parent and majority stockholder of its subsidiary, Conductron, "forced" Conductron to acquire ACI and that such action resulted in MDC's receipt of "something from Conductron to the exclusion of, and detriment to, the minority stockholders of Conductron," and upon such theory plaintiff asserts a derivative claim for damages. The defendants, on the other hand, argue that the issuance of Conductron stock did not confer an unjustifiable benefit on MDC, or

36. The dissenting vote was cast by Siegel, who, nevertheless, testified that "[i]t was a very narrow decision," "a very small thing."

37. Mr. Omberg had been commissioned by Conductron and MDC to investigate ACI's situation and prospects.

38. The $160,172 figure is based upon the closing price of Conductron stock on the American Stock Exchange on February 25, 1967, the date of the ACI acquisition.

deprive Conductron's public shareholders of a legitimate benefit.

The plaintiff first urges that the Conductron-ACI sale was a parent-subsidiary transaction. It is true that MDC controlled Conductron but its ownership of 46 per cent of ACI's stock did not necessarily vest in it control of ACI. Under Delaware law, non-majority stock ownership is not sufficient, by itself, to establish domination and control.

> A plaintiff who alleges domination of a board of directors and/or control of its affairs must prove it. *Blish v. Thompson Automatic Arms Corporation*, 30 Del. Ch. 538, 64 A. 2d 581 (1948). Stock ownership alone, at least when it amounts to less than a majority, is not sufficient proof of domination or control. [Citing cases.]

Kaplan v. Centex Corp., 284 A. 2d 119, 122-23 (Del. Ch. 1971).[39] The trial court found that MDC did not control ACI "in fact or in law" and there is no clear error in such finding.

There is much argument in the briefs as to whether the "intrinsic fairness" test[40] or the business judgment test[41] should be employed to judge the essential fairness of the transaction.[42]

39. *See also Liboff v. Allen*, Civil Action No. 2669 (Del. Ch. Jan. 16, 1975); *Puma v. Marriott*, 283 A. 2d 693, 695 (Del. Ch. 1971).

40. "The standard of intrinsic fairness involves both a high degree of fairness and a shift in the burden of proof. Under this standard the burden is on Sinclair [a parent corporation, dominating a subsidiary] to prove, subject to careful judicial scrutiny, that its transactions with Sinven [its subsidiary] were objectively fair." *Sinclair Oil Corporation v. Levien*, 280 A. 2d 717, 719-20 (Del. 1971).

41. Under the business judgment rule, "a court will not interfere with the judgment of a board of directors unless there is a showing of gross and palpable overreaching." *Id.* at 720.

42. "The results of the cases suggest that the difference between the two standards is not significant ° ° ° ." Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 Harv. L. Rev. 297, 318 n. 49 (1974). However, as appears from notes 39 and 40, *supra*, there is a significant difference, as a practical matter, in burden of proof.

Although there was no parent-subsidiary relationship in this transaction, nevertheless MDC held substantial stock interests on both sides of the transaction and we will thus scrutinize it with care. The plaintiff's argued examples of self-dealing on the part of MDC are weak and unpersuasive. Thus, the purpose of keeping "ACI within the MDC group," if beneficial at all, would equally benefit both MDC and Conductron's public stockholders. Likewise, there was no benefit to MDC from the acquisition by avoiding lending ACI money or paying its losses, since there was no legal obligation for MDC to do so in the first place. Actually, as a result of the acquisition, MDC increased its share of ACI's losses from 46 per cent to 80.5 per cent by virtue of its 80.5 per cent stock ownership of Conductron. Evaluation of the transaction under the business judgment standard provides that:

> In the absence of a showing of bad faith on the part of the directors or of a gross abuse of discretion the business judgment of the directors will not be interfered with by the courts.

Warshaw v. Calhoun, 221 A. 2d 487, 492-3 (Del. 1966). It was the finding of the trial court that in the Conductron-ACI transaction there was an absence of "credible proof of improper motives, self-dealing, control, or unfairness, or any benefit to defendants ° ° °.'' There is no clear error in such ruling and no violation of Delaware law under either the intrinsic fairness test or the business judgment rule.

Plaintiff also charges, with respect to the ACI transaction, as follows: "The forced acquisition of ACI also

violated Section 10(b) of the Securities Exchange Act since it was effected by forcing Conductron to buy securities—the ACI stock." Without stating in so many words, we glean from the two cases cited by plaintiff in support of this argument, *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U. S. 6, 10-11, 92 S. Ct. 165, 30 L. Ed. 2d. 128 (1971); *Travis v. Anthes Imperial Ltd.*, 473 F. 2d 515, 527 (8th Cir. 1973), that plaintiff's reliance is upon the settled proposition of law that deceptive practices "touching" the sale of securities is sufficient to invoke the "in connection with" clause of Rule 10b-5.[43] In *Superintendent of Insurance, supra*, the defendants had caused the corporation they controlled to sell securities at full value in order to subvert the proceeds of the sale to their personal benefit. *Travis* involved self-dealing in "violation of a fiduciary obligation to minority shareholders".[44] We have no quarrel with these cases but neither is apposite. In the instant case, the District Court found, and we have affirmed, that the ACI acquisition did not involve self-dealing or unfairness to the minority shareholders.

In sum, the ACI acquisition, which we have found to be a fair transaction, involved no "manipulative or deceptive device or contrivance" in violation of § 10(b) of the 1934 Act.

The plaintiff also asserts a derivative claim arising out of the Siegel and Olsen "insider" sales of Conductron stock in 1967.

Siegel, as noted *supra*, founded Conductron in 1960 and served as its President and Chairman of the Board. He continued in these positions after MDC acquired control of Conductron in 1966, after which Siegel was the

43. *Superintendent of Insurance, supra*, 404 U. S. at 12-13, 92 S. Ct. 165.

44. 473 F. 2d at 527.

largest minority stockholder. He remained in these positions until January 30, 1967, at which time he became involved in a policy dispute with James S. McDonnell, Chairman of the Board of MDC, involving the Hoffman Electronics Company,[45] and the acquisition of ACI. Siegel ultimately voted against the acquisition of ACI. This was, in fact, not a particularly significant issue at the time since only approximately $160,000 in Conductron stock was involved, this representing about .01 per cent of Conductron's outstanding shares.

Because of and at the time of the dispute over Hoffman and ACI, Siegel resigned as Chairman, President, and Director of Conductron and informed Mr. McDonnell that he intended to dispose of all of his stock of Conductron, which he did in February of 1967. On February 8, 1967 Siegel incorporated K. M. S. Industries, Inc., which company he operated until his death.[46] Immediately following the K. M. S. incorporation, Siegel invested in stocks of and loans to that company of approximately $2,600,000 of profits from the sale of his Conductron stock.

Olsen's association with Conductron commenced in 1961, when he became the corporation's chief financial officer, a Vice-President, and a director. After Siegel's resignation in 1967, Olsen became head of the Company, but only on a temporary basis, since he did not have the technical background for permanent presidency of a research and development company. On April 27, 1967, a Mr. Burke was elected President of Conductron, although Olsen remained as an officer and director until October 21, 1967. His purpose in then leaving was to join Siegel in

45. Plaintiff's derivative claim at trial relating to Conductron's failure to acquire Hoffman Products was abandoned on appeal.

46. Siegel died after trial, but prior to judgment. By order of the District Court, Ruth B. Siegel, Siegel's wife and executrix, was substituted as a defendant.

Siegel's K. M. S. Industries, it having been agreed during the summer of 1967 that he would be released from his employment contract with Conductron. During the summer he disposed of his Conductron stock and invested the proceeds in K. M. S. Industries. On October 21, 1967 Olsen left Conductron and immediately became an officer and director of K. M. S. Industries.

It is not controverted that in view of the fact that Conductron was a Delaware corporation we are controlled by Delaware law. The problem of "insider" sales has a vast literature [47] and is subject to varying conclusions in the various jurisdictions,[48] a not surprising situation in view of the widely accepted principle applied in such cases that "each case of so-called breach of fiduciary duty must be decided on its own facts", as held by the Delaware Court in *Kors v. Carey,* 39 Del. Ch. 47, 158 A. 2d 136, 141 (1960), or, as alternatively put by the Delaware Court in *Equity Corp. v. Milton,* 42 Del. Ch. 425, 213 A. 2d 439, 442 (1965), *aff'd,* 43 Del. Ch. 160, 221 A. 2d 494 (1966):

> The question of whether or not a corporate fiduciary has appropriated for himself something that in fairness should belong to his corporation is "° ° ° a factual question to be decided by reasonable inference from objective facts": *Guth v. Loft, Inc.* [23 Del. Ch. 255, 5 A. 2d 503], cited in *Johnston v. Greene,* 35 Del. Ch. 479, 121 A. 2d 919.

47. *See, e.g.,* Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares,* 46 Cornell L. Q. 53 (1960); Note, *Common Law Corporate Recovery for Trading on Non-Public Information,* 74 Colum. L. Rev. 269 (1974); Note, *Regulation of Insider Trading on the Open Market: A Re-evaluation of Diamond v. Oreamuno,* 9 Ga. L. Rev. 189 (1974); Note, *From Brophy to Diamond to Schein: Muddled Thinking, Excellent Result,* 1 J. Corp. L. 83 (1975).

48. *See* 3A W. Fletcher, *Cyclopedia of the Law of Private Corporations* §§ 1167-1168.2 (rev. perm. ed. 1975).

Leading cases in the area are those of the New York Court in *Diamond v. Oreamuno,* 24 N. Y. 2d 494, 301 N. Y. S. 2d 78, 248 N. E. 2d 910 (1969) and the Delaware Court in *Brophy v. Cities Service Co.,* 31 Del. Ch. 241, 70 A. 2d 5 (1949).[49] The Third Circuit in *Thomas v. Roblin Industries, Inc.,* 520 F. 2d 1393, 1397 (1975), analyzing both cases, stated that:

> We read both *Diamond* and *Brophy* to stand for the same fundamental proposition: as a matter of common law, a fiduciary of a corporation who trades for his own benefit on the basis of confidential information acquired through his fiduciary position breaches his duty to the corporation and may be held accountable to that corporation for any gains without regard to whether the corporation suffered damages as a result of the transaction. This obligation continues even after termination of the relationship which created the fiduciary duty.

So much for the "fundamental proposition." But in its application thorny questions arise, *e.g.,* was "inside" information in fact relied upon, or were the essential facts, or reasonable inferences therefrom, matters of public knowledge? The facts in the *Brophy* case, *supra,* compared with those presented to us, bring into sharp relief the essential differences in the cases and the ground upon which the claims must be rejected. In *Brophy* it was alleged that the defendant, a confidential secretary to a corporate officer and director, took advantage of his advance knowledge that the corporation was about to purchase shares of its own stock on the open market in such quan-

49. "The acquisition of its own capital stock is not ordinarily an essential corporate function, [citations omitted] and in the absence of special circumstances, corporate officers and directors may purchase and sell its capital stock at will, and without any liability to the corporation." *Brophy, supra,* 70 A. 2d at 8.

tities as to cause a rise in its price. It was further alleged that defendant thereupon purchased company stock at a low price, which he subsequently sold at a profit. The complaint was held to state a cause of action. In short, the entire transaction by the officer was entered into, and consummated, on the basis of, and because of, the inside information known secretly to him.

> [T]here can be no justification for permitting officers and directors * * * to retain for themselves profits which, it is alleged, they derived solely from exploiting information gained by virtue of their inside position as corporate officials.

Diamond v. Oreamuno, supra, 24 N. Y. 2d at 498-99, 301 N. Y. S. 2d at 81, 248 N. E. 2d at 912. The Restatement (Second) of Agency § 388, Comment c, expresses the same view:

> *Use of confidential information.* An agent who acquires confidential information in the course of his employment or in violation of his duties has a duty * * * to account for any profits made by the use of such information, although this does not harm the principal. * * * So, if [a corporate officer] has "inside" information that the corporation is about to purchase or sell securities, or to declare or to pass a dividend, profits made by him *in stock transactions undertaken because of his knowledge are held in constructive trust for the principal.* [Emphasis ours.]

In the case at bar defendant Siegel sold his stock in Conductron and withdrew from the company because of a policy dispute with Mr. McDonnell. He sold his stock as a result of such withdrawal and to obtain funds for his new corporation. His associate, Mr. Olsen, followed him out

of Conductron and into Siegel's new corporation because of the desirability of the association, selling his Conductron stock and investing in Siegel's newly formed corporation as a part of his resignation from Conductron and his new association.

The trial court, having taken voluminous testimony, both oral and written, concluded that "neither Siegel nor Olsen violated any fiduciary duty owing to Conductron," and that "[t]here is no evidence whatever that either of them [Siegel or Olsen] wrongfully used inside information, dealt fraudulently with Conductron or seized a corporate opportunity for their benefit. They were not unjustly enriched in fact or in law." There is no clear error in such holding.

Now to consider the 1971 merger of Conductron into the McDonnell Douglas Electronics Co. (MDEC) in 1971. The plaintiff describes it, somewhat pejoratively as a "freeze-out." [50] What is thus characterized is the process by which companies, for a variety of reasons, seek to abandon the public market and return to private ownership, *i.e.*, the process of "going private." [51] The techniques employed vary with the corporate situation presented:

> Reduction of public ownership is most commonly effected by a cash or debt tender offer by the corpora-

50. "The term has come to imply a *purpose* to force a liquidation or sale of a stockholder's shares, not incident to some other wholesome business goal." Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* 77 Harv. L. Rev. 1189, 1192-3 (1964) (emphasis original; footnote omitted).

51. This expression describing the transaction, taken from the financial press, has been widely adopted by legal commentators. *See* Comment, *The Second Circuit Adopts a Business Purpose Test for Going Private: Marshel v. AFW Fabric Corp. and Green v. Santa Fe Industries, Inc.,* 64 Calif. L. Rev. 1184 (1976). Alternatively, the more neutral expression "take-out" has been employed in the literature. *See, e.g.,* Borden, *Going Private—Old Tort, New Tort or No Tort?,* 49 N. Y. U. L. Rev. 987, 989 (1974).

tion to its public shareholders, or to the public shareholders of a subsidiary corporation. Of course it is rare for all offerees to accept such an offer. Complete elimination of public ownership therefore generally requires that the controlling stock interest, if not already held by an operating parent corporation, be placed in a new corporation. The subsidiary can then be merged into, or its assets conveyed before or after dissolution to, its parent corporation on terms which give the subsidiary's remaining public shareholders cash or debt securities in exchange for their equity. Alternatively, public ownership may be eliminated in one fell swoop by a simple merger or asset conveyance. And, on occasion, it has also been eliminated by the use of a massive reverse stock split, converting all public holdings into fractional interests which are then paid off in cash.[52]

The benefits to the corporation are varied:

Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state disclosure laws; the removal of a pressure to pay dividends at the expense of long-term capital development or speculative capital investment—these are some of the advantages which may enure to a corporation "going private". It is essential to underscore that *all* of the above-stated advantages accrue from the *very act of eliminating the 10% shareholders who confer public status on the corporation.*[53]

52. Borden, *supra* note 51, at 978-88 (footnotes omitted).

Per contra, it is clear that the situation is fraught with opportunities for abuse by the majority. Thus there may be the complete absence of any "legitimate business purpose" in the merger, it being merely a device for the aggrandizement of the dominant stockholder or group at the expense of the minority. Speaking of such, the Supreme Court said, in *Pepper v. Litton*, 308 U. S. 295, 311, 60 S. Ct. 238, 247, 84 L. Ed. 281 (1939):

> He [the dominant stockholder or majority] cannot violate rules of fair play by doing indirectly through the corporation what he could not do directly. He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestuis*. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation.

What we are actually called upon to weigh, in these competing considerations in the merger situation, is the interest of the minority in continued stock ownership in the corporation, as against the need for corporate flexibility, which may be exercised, of course, for valid purposes as well as invalid.

53. Judge Moore, dissenting in *Green v. Santa Fe Industries, Inc.*, 533 F. 2d 1283, 1308 (2d Cir.), *cert. granted*, – U. S. –, 97 S. Ct. 54, 50 L. Ed. 2d 74 (1976) (emphasis original; footnote omitted).

The questions before us have been the subject of extensive and learned discussions by the commentators.[54] Many of the "authorities" cited to us have been holdings upon the pleadings, not on the facts. At bar we go beyond the allegations in the pleadings. There has been an exhaustive examination at trial of the various allegations made in the light of facts proven.

The attacks of the plaintiff on the 1971 merger are concentrated in Counts IV and V, containing direct and derivative claims, Count IV alleging statutory violations under the 1934 Act, Count V charging breach of fiduciary duties.

False and misleading statements are charged to be contained in the Consent Statement, issued for purposes of merger, plaintiff invoking both sections 10(b) and 14(a) of the 1934 Act with respect thereto. The individual claims of the plaintiff thereunder were dismissed on the ground of lack of causal relationship.[55] In addition, plaintiff asserts that the 1971 merger was a "freeze-out," violating section 10(b) of the Act as being without a legitimate

54. *See* Borden, *supra* note 51; Brudney, *A Note on "Going Private"*, 61 Va. L. Rev. 1019 (1975); Vorenberg, *supra* note 50; Note, *Going Private*, 84 Yale L. J. 903 (1975).

55. The trial court, noting that 80% of Conductron's stock was held by MDC, which, of course, could have effectuated the merger without minority approval, found that the causal relationship required under sections 10(b) and 14(a) was lacking and thus dismissed plaintiff's individual claims for violations of such sections. The court relied on *Mills v. Electric Auto-Lite Co.*, 396 U. S. 375, 385, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1970), however footnote 7 of *Mills* left open the issue before us. Plaintiff argues that its position is upheld by the reasoning of the Second Circuit in *Schlick v. Penn-Dixie Cement Corp.*, 507 F. 2d 374 (2 Cir. 1974), *cert. denied*, 421 U. S. 976, 95 S. Ct. 1976, 44 L. Ed. 2d 467 (1975), *commented upon in* 63 Calif. L. Rev. 563 (1975); 4 Brooklyn L. Rev. 1279 (1976). But in view of the holding below that neither Conductron nor its shareholders have suffered damage from the merger, it would be an academic exercise, which we will not undertake, to determine whether or not on these facts the causation requirement is satisfied.

corporate purpose, and also that even assuming a legitimate corporate purpose, "the manner in which the freeze-out was accomplished and the exchange ratio[56] established constituted an independent violation of Section 10(b)." In addition it was charged under Delaware law that the terms of the merger were unfair, and that action by a majority stockholder having as its primary purpose the "freezing out" of a minority interest is unlawful regardless of the fairness of the price involved.

We view the charges in the light of the economic situation as disclosed in the record. There is no doubt that Conductron was in danger of imminent financial collapse.[57] In 1967 and 1968 Conductron incurred large losses;[58] by

56. The term has been defined as "the ratio of the number of surviving corporation's shares a stockholder of the disappearing entity receives to the number of disappearing company's shares he surrenders." 5 A. Jacobs, *The Impact of Rule 10b-5* § 116:06, at 5-28 n. 3 (1974) (footnote ours).

57. Judge Higginbotham, E. D. Pa., ruling upon plaintiff Polin's prayer to enjoin the proposed 1971 merger:

> Recognizing that Conductron may be near the brink of financial collapse unless it is assured additional financial assistance, it may be impossible to make an immediate resolution of this controversy which is flawlessly fair—or even satisfactory—in every aspect to each party—the plaintiff, Howard Polin, the other approximately 2600 minority shareholders of Conductron, the 2761 employees of Conductron, and MDC. There are certainly many compelling arguments in plaintiff's favor. But the final and crucial reality before me is that preventing the 1971 merger from proceeding will substantially increase the likelihood of the financial collapse and ultimate bankruptcy of Conductron. The demise of Conductron would harm not only the present employees and other minority shareholders of Conductron but also make impossible the rescission which plaintiff claims he is ultimately entitled to (and for which he seeks the present injunction as the first necessary step in its attainment). Therefore, I find that upon weighing the totality of factors, the balance preponderates against the issuance of the preliminary injunction, even though admittedly my decision is not free from all doubt.

58. Conductron's net loss was $6,054,507 in 1967 and $4,869,641 in 1968.

the end of 1968, Conductron's net worth had dwindled to $1,782,501.[59] In 1969, Conductron's financial position continued to worsen. Its net loss in 1969 was $21,203,258. As of December 31, 1969, Conductron had a net asset deficiency of $19,410,585 and its indebtedness to MDC was $30,950,000. Further evidence of Conductron's dire financial condition is found in the cross-examination of Mr. George S. Roudebush, Vice President and General Counsel of MDC and a director of Conductron until the 1971 merger:

> Q. In fact, for the past three or four years prior to January of 1971, every loan made by Conductron from a commercial lending institution, such as banks, had to be endorsed without reservation or restriction by McDonnell-Douglas, did it not?
> A. Yes, for a certain period that I'm not quite sure how long, but two or three years, anyway.
> Q. And is it your understanding Conductron, with its own assets and resources, had zero credit?
> A. Correct.

By December 31, 1970, Conductron had a net asset deficiency of $16,068,997 and a $12,055,871 deficiency in net working capital. It had no source of funds available for financial rehabilitation. Owning over 80 per cent of Conductron's stock, MDC had, in the past, made substantial loans to Conductron[60] but was unwilling to extend itself further. MDC considered bankruptcy for Conductron, but it was rejected because of the adverse attendant

59. At the close of 1966, Conductron's net worth was $12,148,012.

60. As of May 7, 1971, the amount outstanding was $17 million. MDC had also made grants to Conductron for research and development in the sum of $12 million, which grants were not required to be repaid. The products of such research and development were to be the property of Conductron.

publicity, of its effect upon "the welfare of 3,000 human beings who are at work over in St. Charles, Missouri," and its consequences for the minority shareholders. Conductron was, in fact, in dire financial straits, only existing because of MDC's advances, its countersignature on contracts and its furnishing of payroll funds for the employees. "Nobody would do business with us," testified Mr. David C. Arnold, Conductron's last president.

As for aid through cancellation of Conductron's indebtedness to MDC, such aid was rejected because of the interests and position of MDC's own stockholders. Recapitalization through the issuance of additional Conductron shares was not realistic, since there were grave doubts that such would have any market. In view of its large investment in Conductron, MDC was unwilling to go further in this direction without complete, 100%, ownership of Conductron.

Accordingly, the merger plan was devised. Under its terms, MDEC, a Delaware corporation, was to be formed, with all its issued and outstanding shares to be owned by MDC. This latter corporation would then issue 135,474 shares of its common to MDEC, to be delivered, under the terms of the merger agreement, to the shareholders of Conductron, other than MDC. The separate corporate existence of Conductron was to cease at the time the merger became effective. A Consent Statement, concerning which complaint is made, described the merger agreement and was sent to all Conductron shareholders, but we note that under Delaware law, MDC itself, owning 80.5 per cent of Conductron shares, had sufficient holdings to approve the merger without additional shareholder approval.

The preliminary agreement between McDonnell Douglas and Conductron made on 11 January 1971

> provided that the exchange ration would be based either on the average of the market prices of Conductron and McDonnell Douglas stock for one month ending 11 January, the market prices on 11 January, or the book values on 31 December 1970, whichever was most favorable to the public holders of Conductron stock.[61]

The merger ration was based on the January 11th market prices of $6.20 per share for Conductron and $23.81 per share for MDC, such date being the most favorable to the public shareholders of Conductron. Thus, there was an exchange of .27 shares of MDC stock for each share of Conductron. MDC shares, having a cash value of some $3 million were paid to Conductron public shareholders for their stock. The merger was consummated on May 28, 1971 and in 1972 MDEC's separate corporate existence was terminated, MDEC becoming a division of MDC. The private shareholders of Conductron, rather than being bought out, became shareholders in MDC.

The cases passing upon the validity of mergers having the effect of eliminating the private shareholders agree on one basic proposition, namely, that the presence or absence of a legitimate business purpose for the merger is of critical importance in appraising the bona fides of the transaction.[62] This factor we find stressed in *Green v.*

61. Consent Statement, p. 4.

62. Earlier case law was more restrictive. Thus we find in *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461, 464 (2d Cir.), *cert. denied*, 343 U. S. 956, 72 S. Ct. 1051, 96 L. Ed. 1356 (1952), that § 10(b)

> was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs ° ° ° .

The scope of Rule 10b-5 has now been extended beyond the narrow limits of *Birnbaum* and similar cases. *See Superintendent*

Santa Fe Industries, Inc., supra, 533 F. 2d at 1291, which held that a claim is stated under Rule 10b-5, when it charges "that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose", and in *Bryan v. Brock & Blevins Co.*, 490 F. 2d 563, 570 (5th Cir.), *cert. denied*, 419 U. S. 844, 95 S. Ct. 77, 42 L. Ed. 2d 72 (1974):

> [T]he trial court found the absence of a "business purpose" for the proposed merger ° ° °. In the absence of such business purpose Power Erectors was purely a sham party created to circumvent the rule of law that prohibits a majority of stockholders of a corporation, ° ° ° to force the minority interests to surrender their stock holdings.[63]

62. (Cont'd.)

of Insurance v. Bankers Life & Casualty, supra; Affiliated Ute Citizens v. United States, 406 U. S. 128, 152-53, 92 S. Ct. 1456, 1472, 31 L. Ed. 2d 741 (1972) wherein it was held, the Court finding present misrepresentations as well as a fraudulent scheme:

> To be sure, the second subparagraph of [Rule 10b-5] specifies the making of an untrue statement of a material fact and the omission to state a material fact. The first and third subparagraphs are not so restricted. These defendants' activities ° ° ° disclose, within the very language of one or the other of those subparagraphs, a "course of business" or a "device, scheme or artifice" that operated as a fraud upon the ° ° ° sellers.

63. *See also Marshel v. AFW Fabric Corp.*, 533 F. 2d 1277, 1282 (2d Cir.), *vacated and remanded for consideration of mootness*, — U. S. —, 97 S. Ct. 228, 50 L. Ed. 2d 162 (1976):

> The controlling shareholders of Concord have devised a scheme to defraud their corporation and the minority shareholders to whom they owe fiduciary obligations by causing Concord to finance the liquidation of the minority's interest with no justification in the form of a valid corporate purpose[;]

Vorenberg, *supra* note 50 at 1204:

> [O]nly where there is a *plausible business purpose of the corporation* beyond the majority's desire to enlarge their own stockholdings or to eliminate a minority stockholder should the minority holder be required to choose between what is avail-

Among other bona fide business reasons,[64] imminent financial collapse has been a long-recognized justification for a take-out. Thus in *Matteson v. Ziebarth*, 40 Wash. 2d 286, 242 P. 2d 1025 (Wash. 1952) (en banc), the failing Ziebarth Corporation located another concern willing to continue the business of the corporation under a license agreement, but only if it received an option to purchase all Ziebarth stock, against the wishes of one Matteson who owned an 11 per cent stock interest. In addition to other reasons for upholding the merger transaction, the court stressed that "[t]here was good reason to believe that this option contract was the only salvation for the hard-pressed Ziebarth Corporation" and distinguished an earlier case holding a merger to be fraudulent on the ground that the merger in that case was "not for any *bona fide* business reason, but for the sole purpose of getting rid of a disagreeable stockholder who refused to sell his stock ° ° °." *Id.* at 301, 242 P. 2d at 1034-35 (emphasis original).

In the case at bar it is abundantly clear that the merger was required by the danger of the imminent collapse of Conductron. There is no serious question but that there was a legitimate business reason for the merger.

63. (Cont'd.)
able to him as a result of the action proposed by the majority and the cash value of his shares[;] [Emphasis original.]
Borden, *supra* note 51, at 1001; Comment, 64 Calif. L. Rev. 1184, 1207-16, *supra* note 51.

64. *See Grimes v. Donaldson, Lufkin & Jenrette, Inc.*, 392 F. Supp. 1393, 1402 (N. D. Fla. 1974), *aff'd mem.*, 521 F. 2d 812 (5th Cir. 1975), wherein the court found the following to be valid business reasons for a merger: (1) The two corporations involved were engaged in similar businesses making merger "a logical proposition;" (2) The elimination of potential claims of conflict of interest inhibiting business dealings between the two corporations; and (3) Savings in daily operations amounting to more than $300,000 per year.

There is thus no violation of section 10(b) of the Securities Exchange Act, or of the Delaware law. Plaintiff's argument that "[l]acking any legitimate corporate purpose, the MDC defendants simply forced out the minority in 1971 to realize the benefits that flowed to them from that course ° ° ° [in] clear violation of Delaware law," is not supported by the facts before us.

But plaintiff continues, as we have noted *supra*, that "[e]ven assuming that the 1971 transaction had a legitimate corporate purpose, the manner in which [it] was accomplished and the exchange ratio established constituted an independent violation of Section 10(b)." In connection with this charge, plaintiff asserts self-dealing by MDC, in violation of its fiduciary duties to Conductron's minority shareholders with respect to the 1971 merger.[65] Plaintiff also contends that the District Court erred in finding the terms of the 1971 merger to be fair and equitable. Plaintiff's attack on the District Court's finding of fairness, consists, in large measure, of the same charges of self-dealing which he argues constitute a violation of § 10(b) without regard to the legitimacy of the corporate purpose of the 1971 merger. Specifically, plaintiff charges that MDC decided in late 1969 on a merger with Conductron, but waited until January, 1971, when Conductron's stock had fallen to an artificially low price, to implement that plan. In substance, plaintiff charges that the alleged artificially low price of Conductron stock was the result of MDC actions; chiefly, causing Conductron to refrain from filing a lawsuit against Lockheed, and procuring the delisting of Conductron stock from the American Stock Exchange ("AMEX").

65. We have held that self-dealing in violation of a fiduciary obligation to minority shareholders in connection with a sale or purchase of securities is actionable under § 10(b). *Travis v. Anthes Imperial Ltd., supra*, 473 F. 2d at 527.

With respect to these charges the record is clear that MDC had not yet decided in 1969 on a merger with Conductron. Alternatives, such as recapitalization and bankruptcy, were given serious consideration but rejected, as noted above.

Conductron's 1969 financial statement recognized a loss of approximately $21 million, attributable to its writing off a claim against Lockheed arising out of deficient and delinquent engineering data and aircraft parts furnished to Conductron. Suit against Lockheed had been contemplated. The Chairman of Lockheed's board, Mr. Haughton, upon learning of the possible lawsuit, requested a delay pending a sincere effort by both parties to reach agreement. Such was done and settlement was reached in September, 1970, for a net amount of $6 million, recorded as income in Conductron's 1970 financial statement, and the loss written off in the exercise of reasonable business judgment. The record discloses no impropriety in the handling of this claim against Lockheed, or in the accounting therefor.[66] Plaintiff also charges that MDC knew in 1969 that Conductron stock would be delisted by

66. Note D to Conductron's 1969 financial statement disclosed fully the accounting treatment of the claim against Lockheed:

Note D—Disputed Contract

Divergent interpretations of a contract to produce C-5A aircraft simulators are held by the Corporation and its customer, Lockheed Aircraft Corporation. In December 1969, revised claims totaling approximately $21,000,000 were submitted to Lockheed to cover all costs, plus earnings, attributable to deficient and delinquent engineering data and aircraft parts received from Lockheed.

Inasmuch as negotiations to date have not resulted in contract coverage for these claims, management has elected to charge these claims against current operations. These claims are meritorious in the opinion of counsel, and settlement will continue to be pursued vigorously. Upon final settlement, any recovery will be reflected as earnings in the year of settlement.

the AMEX and that MDC helped to bring about that delisting primarily by writing off the full amount of the Lockheed claims in 1969, and deliberately waited until the delisting of Conductron's stock before implementing the merger.

The AMEX halted trading in Conductron stock on November 11, 1970, and shortly thereafter delisted Conductron stock on account of the corporation's poor financial condition. Prior to the delisting, the AMEX held a hearing, at which Mr. Arnold, the President of Conductron made a presentation. Mr. Arnold testified that at the hearing "I ran through all of the things that we were doing in the company to stop the losses. ° ° ° I tried to do a selling job on them so that even though we didn't meet the requirements of staying listed, that they would leave us on the exchange, but it didn't work."

Delisting followed. We have been cited to no evidence in the record, nor does our own examination thereof reveal that the claim against Lockheed was written off with a view towards procuring the delisting of Conductron's stock by the AMEX.

The much-argued merger, in our judgment, was for a justifiable business purpose, there was no precipitous action taken, and the terms thereof were neither unfair nor violative of any fiduciary duty. As the trial court held

> In our judgment, the credible evidence does not support plaintiff's claim of an ulterior purpose or scheme to freeze out the minority shareholders. Conductron's problems resulted from a myriad of factors, not the least of which was the national depression, particularly in the aerospace industry. We find that the terms of the merger were fair and equitable.

411 F. Supp. at 704.

The court below took testimony at length on the various issues here presented and concluded that the charges made were without foundation. In so holding we find neither error of law nor clear error of fact.

In the view we have taken of the case we find it unnecessary to pass upon additional issues presented.

Affirmed.

COURT OF APPEALS ORDER.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

SEPTEMBER TERM, 1976

No. 76-1207

Howard Polin on behalf of himself and on behalf of all other similarly situated shareholders of Conductron Corporation and derivatively, etc.,

Appellant,

v.

Conductron Corporation, et al.,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI

The Court having considered petition for rehearing en banc filed by counsel for appellant and, being fully advised in the premises, it is ordered that the petition for rehearing en banc be, and it is hereby, denied.

Considering the petition for rehearing en banc as a petition for rehearing, it is ordered that the petition for rehearing also be, and it is hereby, denied.

April 14, 1977

DISTRICT COURT PRE-TRIAL ORDER.

IN THE
UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 72 C 244 (2)

HOWARD POLIN,

Plaintiff,

v.

CONDUCTRON CORPORATION, et al.,

Defendants.

Order.

This matter is before the Court on motions of defendants McDonnell Douglas Corporation et al. and defendants Cutrona et al. to dismiss, to strike, and make more definite and certain.

As to Count I, dismissal is sought only insofar as said count purports to allege a cause of action in favor of plaintiff individually or as a member of a class. The motions as so limited are well taken, leaving unimpaired any claim plaintiff may have derivatively on behalf of Conductron Corporation.

As to Count II, the thrust of the motions to dismiss is that plaintiff has not adequately alleged that he was a shareholder of Conductron Corporation at the time of the

transaction complained of. We believe that when the complaint is read as a whole, sufficient appears for purposes of complying with Rule 23.1. However, plaintiff would be well advised to amend this count by making the specific averment required by the rule.

As to Count III, we hold that as against the motions to dismiss a claim has been stated in favor of plaintiff individually.

As to Counts IV and V, we have concluded that a claim for breach of fiduciary duties has been stated.

Accordingly, the motions to dismiss are sustained as to Count I insofar only as said count purports to allege a claim in favor of plaintiff individually and as member of a class, and overruled as to Counts II, III, IV and V.

The motions to strike are related to defendants' other motions. Although some of the allegations might well be stricken in view of our ruling on the various other motions of defendants, we have concluded that at this stage of the case the motions should be and they are hereby overruled without prejudice.

The motions for a more definite statement are hereby overruled.

Dated this 23rd day of January, 1973.

/s/ JOHN K. REGAN
United States District Judge

DISTRICT COURT PRE-TRIAL MEMORANDUM AND ORDER.

IN THE
UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 72 C 244 (2)

HOWARD POLIN,

Plaintiff,

v.

CONDUCTRON CORPORATION, et al.,

Defendants.

Memorandum and Order

In this consolidated case transferred from the Eastern District of Pennsylvania, the propriety of designating as class actions the claims alleged in Counts I, III, IV and V is for decision.

First as to Count I. Plaintiff, a stockholder in Conductron Corporation (Conductron), seeks relief on behalf of himself and others holding stock in Conductron in 1966 on the premise that the acquisition by McDonnell Douglas Corporation (McDonnell Douglas) of an 80 per cent control of Conductron resulted from a proxy statement and letter which violated Sections 10(b) and 14(a) of the

Securities Exchange Act and Rules 10b-5 and 14a-9 thereunder.

In essence, plaintiff complains of a transaction whereby Conductron exchanged newly authorized and issued stock for certain assets of McDonnell Douglas, the consideration received by Conductron being allegedly grossly inadequate. In order to consummate the exchange, it was necessary for the stockholders to authorize, by majority vote, an increase in its capital stock. A proxy statement, together with an accompanying letter by defendant Keeve M. Siegel which contained allegedly false and misleading statements and omissions, was mailed to the stockholders. By affidavit, not denied by plaintiff, it appears that defendants McDonnell Douglas and Keeve M. Siegel together owned more than 50 per cent of the outstanding stock of Conductron.

It is plaintiff's position that in addition to stating a derivative action on behalf of Conductron, Count I states a representative claim on behalf of Conductron's stockholders. We do not agree. As for the Section 14(a) claim based on alleged defects in the proxy solicitation materials, we find nothing in *Mills v. Electric Autolite Co.*, 396 U. S. 375, relied on by plaintiff, as mandating a contrary ruling. In *Mills*, the Supreme Court held that the stockholders' case was made out "by showing that proxies *necessary* to approval of the merger were obtained by means of a materially misleading solicitation" (396 U. S. 1c 386).

Plaintiff misconstrues *Mills* and other cases when he relies on statements in the opinions that once the shareholder proves a material or misleading statement having a *propensity* to affect the voting process, it is not necessary to further prove "whether the defect actually had a decisive effect on the voting." In our judgment, this can only

mean that the necessary causal connection is shown if "*the proxy solicitation itself,* rather than the particular defect in the solicitation materials, was an *essential* link in the accomplishment of the transaction." In the instant case, since the votes of two of the alleged conspirators sufficed to obtain approval of the transaction, the proxy *solicitation,* much less the particular defect therein complained of, was neither necessary nor an essential link in the accomplishment of the transaction. On the record as it now stands, plaintiff does not state a representation claim in Count I under Section 14(a) and Rule 14a-9.

As for the Section 10(b) and Rule 10b-5 claim asserted in Count I, it must also fail as a representation claim inasmuch as plaintiff is neither a purchaser nor seller, actual or constructive, in connection with the questioned 1966 transaction and thus has no standing to maintain the action under Rule 10b-5.

If, as plaintiff alleges, Conductron was damaged by reason of the sale of assets by McDonnell Douglas at an inflated price, that claim belongs to Conductron (cf. *Hooper v. Mountain States Securities Corp.,* 5 Cir., 382 F. 2d 795), and is in fact sued for derivatively. Assuming plaintiff proves his entitlement to recovery on behalf of Conductron, and defendants are compelled to make good the amount by which the value of Conductron stock was diminished by reason of the exchange of assets, full redress on the Count I claim will necessarily have been accorded to plaintiff and the other minority stockholders. In view of our ruling, it is unnecessary to determine whether the requirements of Rule 23 for a representative class action are met as to the Count I claim.

Next as to Count III. That count seeks recovery under Sections 10(b) and 14(a) of the Securities Exchange Act on behalf of all Conductron stockholders (esti-

mated to number in excess of 2600) who purchased Conductron stock between January, 1966 and July, 1969,[1] "in reliance upon, directly or indirectly, the false and misleading proxy statements, financial statements, Annual Reports, and other documents prepared under the direction or with the participation, acquiescence, encouragement, cooperation, or assistance of the defendants, or reliance upon, or as a result of the artificially inflated market price of Conductron stock resulting from such misleading proxies and other misleading documents and/or from such induced purchases."

When the allegations of Count III are analyzed in light of certain other facts shown by affidavit, it becomes apparent that the claim would be completely unmanageable if it were sustained as a class action. The purported class consists of those stockholders who allegedly purchased Conductron stock in 1966, 1967, 1968, and 1969. A number of documents issued over the years are alleged to contain certain misleading and false representations as well as omissions. Parenthetically, we note that most of the allegedly false representations were made in the 1966 proxy and letter upon which the Count I claim is based. True, plaintiff asserts that the price of Conductron stock was artificially inflated as the result of the totality of the misleading statements, but even so, the time and amount of such allegedly inflated price as related to individual purchases would be of importance in determining the rights of each purchaser. And obviously, those persons who purchased stock in 1966 could not have been influenced in any way by any false representations or omis-

1. This suit was filed July 23, 1969. The consolidated amended complaint filed in July, 1972, states the alleged class as including all purchasers of Conductron stock from January, 1966 to "the present." We accept plaintiff's representation that by the words "the present" he meant the date on which this suit was originally filed.

sions made in 1967, 1968 nor 1969, even if the representations and omissions subsequently made were the same in each proxy and "other document."

In his complaint, plaintiff poses a number of "questions" which he alleges are common to all members of the alleged class. What he overlooks is that even if some or all of these questions are in fact common, a matter which we do not definitively rule, the answers to most of the questions would raise a whole series of other questions which would not be common. In our judgment, the facts common to purchasers in the various years do not, under the present record, predominate. This is particularly true in light of the fact that the composition of the Conductron directorate changed from time to time during the period alleged.

We hold, therefore, that the factual issues, as the record now stands, are too diverse to warrant class treatment. In this situation we do not determine whether plaintiff's individual claim is in fact typical, in that it appears that plaintiff purchased a very substantial number of shares of Conductron stock after he became aware of the facts complained of in Count III.

As to Count IV, we believe that the rationale of our holding with respect to Counts I and III requires a like result. This is certainly so as to the Section 14(a) claim based on the proxy statement. And since the merger of Conductron into a wholly owned subsidiary of McDonnell Douglas undoubtedly resulted from McDonnell Douglas' 80 per cent voting power, the Section 10(b) claim must fall as well. In light of the undisputed facts, the underlying complaint of plaintiff in Count IV is not that the allegedly misleading statements and omissions actually brought about the merger with its alleged resultant damage, but rather that defendant McDonnell Douglas was unjustifiably enriched by the breach of defendants'

fiduciary obligations. Moreover, plaintiff of all people was not misled by any statements of defendants since he was attempting to enjoin the merger. Hence, if plaintiff has a federal claim at all with respect to the Count IV allegations, any such claim is not typical of the claims of the other members of the alleged class.

This brings us to Count V as to which pendent jurisdiction is alleged. Count V seeks recovery for the same matters complained of in Count IV but expressly based on breach of defendants' fiduciary duties. Since we have declined to permit the basic claim to continue as a class action, we deem it inappropriate to permit Count V to be prosecuted as such, there being no pendent jurisdiction as to the class action portion of the claim.

It follows from the foregoing that the motion of plaintiff to designate Counts I, III, IV and V as a class action should be and is hereby denied, and that the motion of defendants Cutrona et al. to dismiss Counts I and III as a class action and the motion of defendants McDonnell Douglas Corporation et al. to dismiss Counts I, III, IV and V as a class action should be and each of them is hereby sustained without prejudice.

Dated this 23rd day of January, 1973.

/s/ JOHN K. REGAN
United States District Judge

DISTRICT COURT POST-TRIAL OPINION.

UNITED STATES DISTRICT COURT
E. D. Missouri, E. D.

January 23, 1976.

Nos. 72 C 244(2), 72 C 245(2).

Howard POLIN on behalf of himself and on behalf of all other similarly situated shareholders of Conductron Corporation and derivatively, on behalf of Conductron Corporation,

Plaintiff,

v.

CONDUCTRON CORPORATION et al.,

Defendants.

Memorandum Opinion and Order.

Regan, *District Judge.*

This action filed by Howard Polin, a shareholder of Conductron Corporation, was transferred to this Court from the Eastern District of Pennsylvania.[1]

1. Originally, there were two suits involving different aspects of Polin's claims, maturing at different times. Both of these suits were transferred to this district. By order of court, they were consolidated into one action for all purposes. Thereafter plaintiff filed a consolidated amended complaint embodying the claims in both actions.

The consolidated amended complaint charges defendants with various violations of the Securities Exchange Act of 1934 and regulations thereunder as well as with breaches of fiduciary duties owing by them under Delaware law. Basically, the complaint attacks the acquisition by McDonnell Douglas Corporation of a controlling interest in Conductron stock in January, 1966, the operation of Conductron thereafter, and the ultimate merger of Conductron into a wholly owned subsidiary of McDonnell Douglas. Both individual and derivative claims are alleged.

Defendants are McDonnell Douglas Corporation which, since January, 1966, and until the merger owned 80.5% of the capital stock of Conductron and a number of individuals who at various times were officers or directors of either or both Conductron and McDonnell.

Conductron, a Delaware corporation, was an electronics research and development firm in Ann Arbor, Michigan, with sales for the year ending December 31, 1963 of some $5,000,000. McDonnell Aircraft Corporation (which later became defendant McDonnell Douglas Corporation) was a St. Louis-based manufacturer of aircraft and aerospace products with sales for the year ending June 30, 1964 of $865,000,000. In that year it purchased 20% of the outstanding common stock of Conductron, following which defendants Lewis and Roudebush (directors and officers of McDonnell) were elected to Conductron's Board of Directors.

On January 7, 1966, after arms-length negotiations which extended well over a year, McDonnell and Conductron entered into a conditional agreement whereby McDonnell was to acquire 1,850,000 newly issued shares of Conductron stock in return for the business and assets of McDonnell's Electronic Equipment Division, five million dollars cash, and all the capital stock of Tridea Electronics Company, a wholly owned subsidiary of McDonnell. Such

acquisition, together with its contemporaneous purchase of 50,000 shares of stock owned by defendant Keeve M. Siegel, would result in McDonnell owning 80.5% of Conductron's outstanding stock, thereby placing it in "control" as that term is defined in the Internal Revenue Code. A Conductron stockholders meeting was called for January 25, 1966, to consider the transaction. Notice of the meeting, together with a proxy statement and a letter from Siegel (its president and principal individual stockholder), was mailed to shareholders at their addresses of record. With Siegel and McDonnell constituting a majority of the voting stock, stockholders' approval was little more than a formality. Following that approval at the January 25 meeting, the transaction was closed on January 27, 1966.

We first consider plaintiff's individual claims. These are based on alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)5 thereunder. The violations consist of allegedly misleading statements and reports made by various defendants, following each of which plaintiff continued his pattern of making additional purchases of Conductron stock. Complained of are the January 12, 1966 proxy statement and the various annual and quarterly earnings reports issued by Conductron thereafter, as well as press releases.

Whether plaintiff actually received and read the various statements and reports is a controverted issue. The credibility of plaintiff is attacked by defendants, and we have concluded that plaintiff has failed to establish by credible evidence that he received and read the documents in question. Complicating the situation is the fact that plaintiff made some 65 separate purchases of Conductron stock prior to filing suit.

It is plaintiff's contention that the proxy statement was fraudulently misleading by reason of alleged omissions of material facts chiefly relating to aircraft simulators and

various problems likely to be encountered by Conductron in that business, at least for the first several years. In the light of hindsight, it may well be that the proxy statement was conservative in its estimates as to the future. However, considering the then known facts, it is our view that the projections made in the statement are neither false nor misleading, either by way of affirmative representations or omissions therefrom.

As of the date of the January, 1966 proxy statement, plaintiff was the owner of 200 shares of Conductron stock which he had bought in May, 1965, at an average cost of 23⅛ per share. On February 18, 1966, plaintiff purchased an additional 400 shares, 100 at 50¾ and 300 at 50⅝. No further purchases were made until October 12 (100 shares at 42).

In April, 1966, after McDonnell had acquired its controlling interest, Conductron's 1965 annual report was issued, this being followed in September by its "Annual" report for the six months ending June 30, 1966. As to these and the other reports, it is plaintiff's contention that they too contain omissions of essential facts relating to difficulties likely to be encountered by Conductron, by reason of which they presented a false and misleading picture of Conductron's operations and prospects. After the 1965 and the 1966 Annual reports were issued plaintiff purchased an additional 600 shares of Conductron. The prices paid (in February, 1967) ranged from a high of 58½ to a low of 44¾.

In the latter part of April, 1967, Conductron's "Annual" report for the last six months of 1966 (which included the sales and earnings of the first quarter of 1967) was issued. The reports disclosed very substantial losses which had been incurred in Conductron's aircraft simulator program. Nevertheless, plaintiff continued his pur-

chases, acquiring some 2600 shares prior to the issuance of a press release in January, 1968. Thereafter, before Conductron issued its 1967 annual report in April, 1968 and a press release at that time, plaintiff purchased an additional 500 shares. Then he acquired another 3700 shares of Conductron stock from April, 1968 through December of that year, including 1400 shares which he purchased after correspondence with the then president of Conductron relating to plaintiff's allegations of McDonnell improprieties. In April, 1969, the 1968 annual report was issued. This was after plaintiff had consulted with counsel in March of 1969 concerning the liability of defendants for their alleged fraud. It is also not without significance that as early as December, 1968, plaintiff had complained to the Securities Exchange Commission respecting what he believed to be improper actions of McDonnell Douglas. This was shortly after he had purchased 1900 shares of Conductron stock in September and November of that year.

As we have indicated, we have carefully reviewed each of these reports, as well as the earnings statements and the press releases, in light of plaintiff's complaints and find that none of them are fraudulently misleading either by omissions or by affirmative statements. It is true, of course, that each report painted a gloomier picture of the extent of the losses incurred and anticipated than the preceding one, but there is no substantial basis for the contention that any of the reports withheld material information or fraudulently minimized losses which should have been anticipated.

In view of our holding that plaintiff neither received nor read these reports, he could not have relied thereon in making any purchases of Conductron stock. In truth, the pattern of his acquisitions is difficult to understand

from the point of view of reliance on the alleged fraud. Thus, after his initial acquisition of 400 shares in the month after the proxy statement was issued, no purchases at all were made until October 12, 1966, some eight months later, when plaintiff bought 100 shares of stock at 42, down 8⅝ths from his earlier purchases. Then, in February of 1967, about four months later, before any other material was issued by Conductron, plaintiff purchased some 400 shares of stock in 100 share lots at prices ranging from 58½ on February 1st to 54⅜ on February 16th, followed by a fifth 100 share purchase on February 24th at 44¾. No explanation is given of this 10 point drop in an 8-day period. In the two month period commencing September 21, 1967, as the price of the Conductron stock he bought fell from 41⅞ to 31, plaintiff made nine additional purchases aggregating some 1800 shares. And in the month ending January 16, 1968, when Conductron price was hovering in the mid-thirties, another 800 shares were purchased. In April, 1968, prior to the issuance of the 1967 annual report, plaintiff resumed his purchases with the acquisition of 500 shares, 200 at 29⅝ and 300 the following week at 31¼. In May, 1968, when the price of the stock was fluctuating between a low of 39¾ and a high of 47½ (in spite of the substantial losses and the prospects of additional losses which Conductron had publicly reported the previous month), plaintiff bought another 1300 shares. In June of that year additional purchases of 500 shares were made, the first lot of 200 at 47⅝ and the last 300 shares at 41. This pattern of purchases does not, in our judgment, indicate reliance upon any fraudulent representations or omissions.

The basic element of a Section 10(b)5 claim is *causation*, namely that the alleged fraud resulted in damage. *Affiliated Ute Citizens v. United States*, 406 U. S. 128, 92 S. Ct. 1456, 31 L. Ed. 2d 741 (1972). Normally, a case is

made when a plaintiff proves an out-of-pocket loss which results from material misrepresentations of facts or fraudulent omissions. Such out-of-pocket loss would be the difference between the purchase price and the actual value of the stock at the time of purchase. To sustain a recovery on this basis the plaintiff must show that the Conductron stock he bought was in fact of less value than the price he paid for it at the time of purchase. Unless the stock purchased is of lesser value than the price paid, then, notwithstanding the falsity of any alleged representation, the purchaser has suffered no loss and is entitled to no damages. *Harris v. American Investment Company,* 523 F. 2d 220 (8 Cir. 1975).

Recognizing this problem and his failure to adduce evidence as to the actual value of the stock at or near the time of his purchases, plaintiff now contends (citing *Harris,* supra) that damages may be assessed on the basis of the value of the stock at the time the *public* discovered the alleged falsity of the representations, a rule applied in situations where the stock is publicly traded, as Conductron was. On this theory, too, there is a failure of proof, in view of the absence of evidence both as to some dates upon which the alleged frauds were "discovered" by the public and as to the "actual" value of the stock as of such dates. True, there were fluctuations from time to time in the publicly traded prices of Conductron, but no relationship between these fluctuations and the alleged misrepresentations has been shown. It would appear that the fluctuations in the market price of the stock resulted from factors unrelated to the alleged misrepresentations, and we so find. In our judgment the credible evidence does not justify a finding that the market value of the stock was artificially inflated or deflated by any of the alleged misrepresentations.

We next consider plaintiff's derivative claims. The first of these relates to the aircraft simulator business venture in which Conductron became involved following its acquisition of McDonnell's Electronic Equipment Division. In essence, plaintiff's theory on this claim is that McDonnell, for its own benefit, "forced" Conductron to engage in the aircraft simulator business to the detriment of the interests of its minority stockholders.

Delaware law governs. Plaintiff argues that the applicable test in judging the propriety of defendants' conduct is that of "intrinsic fairness," whereby controlling shareholders or directors of the corporation are held to the same standard of care as the trustee of an express trust, citing *Guth v. Loft,* 23 Del. Ch. 235, 5 A. 2d 503, affirmed 23 Del. Ch. 138, 2 A. 2d 225 (1938) and *Overfield v. Pennroad Corp.,* 42 F. Supp. 586 (D. C. Pa. 1941). On the other hand, defendants rely on the "business judgment" rule, to the effect that absent a showing of bad faith or a gross abuse of discretion (as to which the complainant has the burden of proof) a court will not second-guess the judgment of a corporation's directors.[2] *Warshaw v. Calhoun,* 221 A. 2d 487 (Del. Supr. 1966). Under the facts here involved, we believe the "intrinsic fairness" rule is inapposite.

In the final analysis what plaintiff is contending is that in view of the risks inherent in the business, McDonnell itself should have undertaken the simulator program and thereby, in the likely event it proved unprofitable, sustain 100 per cent of the loss instead of the 80.5 per cent which by reason of its stock ownership it actually sustained. This

2. Plaintiff also contends that even under the business judgment rule defendants should be held liable for at least 18 millions of the 54 million dollars loss which Conductron ultimately incurred in the aircraft simulator business. As appears infra, we hold otherwise.

hindsight approach falls far short of demonstrating any impropriety. It is evident to us that at the time the decisions were made, all of the parties involved, including defendant Siegel, who had most to lose as a minority stockholder, acted in the good faith belief that the simulator venture would ultimately prove profitable and be in the best interests of Conductron. We find no abuse of discretion.

Plaintiff's second derivative claim pertains to the rejection of the proposed acquisition of Hoffman Electronics and Hoffman Products Corporation. He contends that McDonnell and the Conductron directors elected by it breached their fiduciary duties to Conductron by deciding not to consummate the Hoffman purchase. We do not agree. These defendants had sound and legitimate business reasons for opposing the acquisition and acted thereon in good faith and in the exercise of their discretion. True, there was a difference of opinion, as evidenced by defendant Siegel's strong feelings in favor of the purchase, but that is a far cry from substantial proof of impropriety. So, too, the mere fact that the Hoffman companies earned profits in the following years does not make these defendants liable to Conductron for the amount of the profits.

Plaintiff also complains of the acquisition by Conductron of Advanced Communication, Inc. (ACI), a small company engaged in the production of advanced electronic devices. Although McDonnell owned a 46% interest in ACI, it did not "control" that company in fact or in law. Absent, as here, credible proof of improper motives, self-dealing, control, or unfairness, or any benefit to defendants, plaintiff has failed to demonstrate any actionable wrong.

We turn next to plaintiff's claim based on the 1971 merger of Conductron into McDonnell Douglas Electron-

ics Company, a wholly-owned subsidiary of McDonnell. The thrust of the claim is that the merger was the culmination of a scheme to freeze out Conductron's minority stockholders at an inequitable exchange ratio. The first stage of the alleged scheme was to transfer McDonnell's loss operation (the aircraft simulators and ACI) to Conductron with resultant insolvency. The second stage of the alleged scheme was to provide capital to Conductron in the form of loans rather than capital contributions even though Conductron was insolvent and the loans could not be repaid. The final stage of the alleged scheme was to liquidate Conductron at an artificially low price (after taking all possible steps to depress the value of its stock), at a time when defendants knew that Conductron's profit picture for the future was brightening.

In our judgment, the credible evidence does not support plaintiff's claim of an ulterior purpose or scheme to freeze out the minority shareholders.[3] Conductron's problems resulted from a myriad of factors, not the least of which was the national depression, particularly in the aerospace industry. We find that the terms of the merger were fair and equitable.

Remaining for determination are the separate derivative claims against defendants Siegel, Olsen and Cutrona. Plaintiff alleges that these defendants breached their fiduciary duties by authorizing the sale of control of Conductron to McDonnell in 1966. The case principally relied on by plaintiff is *Insuranshares Corporation of Delaware v. Northern Fiscal Corporation*, 35 F. Supp. 22 (D. C. Pa. 1940). That was a suit "to recover damages incurred by

3. It is interesting to note that on the one hand plaintiff contends that defendants kept the stock at an artificially inflated level (by means of material misrepresentations and omissions) and on the other hand argues that they forced the market price down in furtherance of the alleged freeze-out scheme.

the corporation as a result of the sale of its control to a group who proceeded to rob it of most of its assets." Liability was imposed because the sellers failed, in light of the known surrounding circumstances, to make a reasonably adequate investigation to determine whether control was to be acquired by improper means and for an improper purpose—that is, whether fraud was intended or likely to result. No comparable situation is here involved. McDonnell, the purchaser, enjoyed the highest reputation for financial and business responsibility. The sellers of control carefully investigated the proposal in all its facets and concluded, in the good faith exercise of business judgment, that the transaction would be beneficial to Conductron. Fraud was neither intended nor likely to result from a transfer of control. And significantly, Siegel still owned over 88,000 shares and Olsen and Cutrona retained their stock ownership. No breach of fiduciary duties has been proven.

A further claim asserted against Siegel and Olsen only is that they wrongfully made "insider profits" by selling their Conductron stock while in possession of information not disclosed to the public, and so should be liable to the corporation under Delaware law. The alleged "inside information" relates primarily to the projected losses Conductron would incur in the simulator business and from the acquisition of ACI. We hold that neither Siegel nor Olsen violated any fiduciary duty owing to Conductron.

As for Siegel, what happened is that when he failed to persuade the other members of the executive committee to agree to the Hoffman acquisition, he resigned as president and director, and shortly thereafter (in February, 1967) sold all his Conductron stock, using the proceeds to organize a new company. At that time, he had every reason to believe the simulator business would be successful. As for Olsen who had long been associated in business with Siegel, he remained for a time with Conductron after Siegel left. After negotiating a cancellation of his employment contract he sold his Conductron stock in July, 1967, primarily to purchase stock in Siegel's company with which he later became associated as an officer.

Plaintiff relies upon *Brophy v. Cities Service Co.*, 31 Del. Ch. 241, 70 A. 2d 5 (1949). In that case, a corporate insider (the confidential secretary to a corporate director) was held liable to the corporation for the profits he realized on the purchase of stock before public disclosure of the fact that the company intended to purchase a quantity of its shares, a fact which would result in a rise of the market price of the stock. Clearly, in that situation, the insider was profiting at the expense of the corporation. The basis of the decision is that for the purpose of removing temptation to profit from a breach of his confidential relationship, an officer or director of a corporation who, in violation of his duty as such, acquires gain or advantage for himself, is liable to the corporation for the benefit or profit so acquired.

As we view the facts, the *Brophy* rule is not here applicable. The good faith and proper motivations of Siegel and Olsen is plainly evident. There is no evidence whatever that either of them wrongfully used inside information, dealt fraudulently with Conductron or seized a corporate opportunity for their benefit. They were not unjustly enriched in fact or in law.

The foregoing memorandum constitutes our findings of fact and conclusions of law. Judgment will be entered in favor of defendants and against plaintiff on all counts.

Supreme Court, U. S.
FILED
AUG 15 1977
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-80

HOWARD POLIN,
Petitioner,

v.

CONDUCTRON CORPORATION, et al.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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RESPONDENTS' BRIEF IN OPPOSITION

QUESTION PRESENTED

Should this Court grant certiorari to examine petitioner's right to another trial, under a different label, of facts already decided against him, and where it has been finally determined that he was not injured and therefore had no loss?

STATEMENT OF THE CASE

This action, filed in 1969, originally embodied a broadside assault against respondents and challenged virtually every management decision made by them during a period of five years. After a lengthy trial, all of those claims were resolved adversely to plaintiff, and that determination was affirmed in a compre-

hensive and scholarly opinion by the Eighth Circuit authored by Senior District Judge Talbot Smith. Petitioner now seeks to present to this Court a narrow and somewhat esoteric issue in this case, which is set against a distinctive, though rather confusing, background.

In Counts IV and V of his complaint, petitioner challenged the 1971 merger of Conductron Corporation into a newly created subsidiary of respondent McDonnell Douglas Corporation. That merger occurred at a time when Conductron had cumulative losses of almost $30,000,000 and had a net asset deficiency in excess of $16,000,000. After exploring various alternatives in order to save Conductron from bankruptcy, respondents finally determined that the only feasible solution to Conductron's continuing financial problems was a merger. Accordingly, on May 7, 1971, a Consent Statement concerning the merger agreement was sent to all Conductron shareholders. It was not necessary to solicit proxies because McDonnell owned enough shares of Conductron (more than 80%) to insure approval of the merger even if all public shareholders objected. The merger was eventually consummated, with Conductron shareholders receiving McDonnell common stock valued at $6.43 for each Conductron share, which at the time had a *negative* book value of $6.22.

Counts IV and V of the complaint assailed the merger under § 10(b) and § 14(a) of the Securties Exchange Act of 1934 and also alleged that the merger was planned and consummated by respondents in violation of their fiduciary duties to petitioner under state law. The basis of all these interrelated claims was that the merger was unfair and the representations made in connection with it were false.

Prior to trial, respondents moved to dismiss the federal claims. In view of McDonnell's stock ownership, the pleadings affirmatively disclosed a lack of any possible causation between any alleged misstatements in the Consent Statement and the con-

summation of the merger. The district court granted that motion but, in another order issued contemporaneously, said (A42):

> "As to Counts IV and V, we have concluded that a claim for breach of fiduciary duties has been stated."

At trial, petitioner vigorously contended that the merger was unfair under state law, for the same reasons that he now says the Consent Statement was misleading. The trial court heard the evidence and concluded that the merger was effected for a valid business purpose and did not result from a breach of fiduciary duties; in particular, the court found that "the terms of the merger were fair and equitable" (A58). On appeal, petitioner again complained repeatedly about the terms of the merger and respondents' actions in connection therewith. The Court of Appeals in several instances discussed petitioner's challenges to the Consent Statement (A30, A31 and A33) and then ruled as follows (A39):

> "The much-argued merger, in our judgment, was for a justifiable business purpose, there was no precipitous action taken, and the terms thereof were neither unfair nor violative of any fiduciary duty."

The Court of Appeals also pointed out that the attack upon the Consent Statement was inextricably intertwined with the unfairness claim and required analysis of the same facts (A37):

> "Plaintiff also contends that the district court erred in finding the terms of the 1971 merger to be fair and equitable. Plaintiff's attack on the District Court's findings of fairness consists, in large measure, of the same charges of self-dealing which he argues constitutes a violation of §10(b) without regard to the legitimacy of the corporate purpose of the 1971 merger."

The Court of Appeals affirmed the findings (a) that respondents had not breached their fiduciary duties and (b) that the terms of the merger were fair and equitable to the public shareholders of Conductron.

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

I. The Issues on Which Petitioner Seeks a Trial Have Already Been Tried and Resolved Adversely to Him.

The issues which petitioner seeks to bring before this Court are simply not presented in justiciable form by this case. In reality, petitioner is asking this Court to review the decision below in order to determine whether he should be permitted to affix a different label to his cause of action (under the Federal Securities laws) and to retry the same facts and issues which were decided against him by the district court and affirmed by the Court of Appeals. The various charges intermingled by petitioner in Counts IV and V of his complaint, when reduced to their essence, challenged the fairness of the 1971 merger to the Conductron public shareholders. The common law claims which have been tried focused on the allegations that respondents breached their fiduciary duty in misleading the petitioner and subjecting him to an unfair merger. The primary assault upon the Consent Statement in petitioner's pleadings was that it "falsely represented that the plan and agreement represented a fair exchange for the public shareholders of Conductron." The courts below resolved all these contentions against petitioner, and those determinations are now final. Petitioner now asks this Court to sanction relitigation of those same facts under a different label in spite of the fact that such a retrial would be barred by the doctrine of collateral estoppel. See *Ashe v. Swenson*, 397 U.S. 436 (1970).

Contrary to petitioner's intimations, the Court of Appeals did not hold that the policy of full disclosure was unimportant, nor did it retreat in any way from the teachings of this Court. It simply held, in accordance with sound judicial principles, that it would not undertake to analyze the accuracy of the Con-

sent Statement under federal law after it had already been determined under state law that the basic allegations underlying the challenge to the Consent Statement were unsupportable. The only precedent to be derived from the court's holding is that a defeated plaintiff will not be permitted to retry his lawsuit a second time under a different theory.

II. Petitioner Is Seeking an Advisory Opinion.

Petitioner is asking this Court to do what the Court of Appeals properly refused to do, *i.e.*, to undertake "an academic exercise" (A30, n. 55) for the purpose of deciding questions which could have no effect on the legal rights of the parties. Said another way, petitioner is asking this Court to grant certiorari for the purpose of issuing an advisory opinion.

Both lower courts have held that the challenged merger was fair and equitable and, therefore, that petitioner was not damaged by its effectuation. Petitioner does not challenge that ruling in this Court. It cannot be disputed that injury or "loss causation" is an essential element of a cause of action under the securities law. *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), *cert. denied* 421 U.S. 976 (1975); *Browning Debenture Holders' Committee v. DASA Corp.*, 524 F.2d 811 (2d Cir. 1975). Since petitioner would not be entitled to any relief even if he prevailed on the questions posed by his petition, he has not presented a viable, justiciable issue to this Court. See *Ashcroft v. Mattis*, 45 U.S.L.W. 3751 (1977).

In this connection, petitioner's reliance upon *Mills v. Electric Auto-Lite Company*, 396 U.S. 375 (1970), is infected by a conspicuous failure to report the most recent chapter in that saga. On April 7, 1977, the Seventh Circuit in *Mills v. Electric Auto-Lite Company*, 552 F.2d 1239 (7th Cir. 1977), held that the terms of the merger were fair and that plaintiffs could not recover. In formulating the issue, the court said, *l.c.* 1243:

> "Damages must be based on evidence that the Auto-Lite minority shareholders were not paid a fair price . . ."

And after analyzing the evidence, the court concluded, *l.c.* 1249:

> "We therefore hold that the terms of the merger were fair and that plaintiffs should recover no damages."

In the absence of a compensable injury, a retrial of the Consent Statement claim would be an empty ritual. Petitioner's attempt to skirt this fatal flaw by asking for rescission is unavailing. If he has not been injured, he cannot obtain any relief of any kind. Since the law of the case establishes that he has not been injured, he has no live issue to present to this Court.

III. The Decision Below Was Correct and Does Not Conflict With Any Decision of This Court or Any Other Court.

Petitioner's artificial attempts to create a conflict with this Court's decisions or with those of other Circuits cannot withstand analysis. There is no basis for any assertion that the decision below runs counter to *Santa Fe Industries v. Green*, 51 L.Ed.2d 480 (1977). *Santa Fe* was a pleadings case in which the Court of Appeals had held that the use of a Delaware short-form merger was in violation of Rule 10b-5 even though there was no misrepresentation or deception. Petitioner here urged in the Eighth Circuit that the Second Circuit's ruling in *Santa Fe* required a valid business purpose in order to justify the merger. The Eighth Circuit, out of an abundance of caution, scrutinized the Conductron merger and found a valid business purpose—that of saving Conductron from bankruptcy. Whether the Court of Appeals was required to make that analysis under this Court's ruling in *Santa Fe* is immaterial, for petitioner's position can in no way be enhanced by this Court's disposition of *Santa Fe*.

Petitioner also asserts that the decision below is contrary to *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255 (3d Cir. 1972), *cert. denied*, 409 U.S. 874 (1972). Here, petitioner's claims have been resolved adversely to him in this very same lawsuit, and the terms of the merger have been found to be fair. In *Kohn*, certain facts which had been adjudicated in other litigation were held not to preclude findings relating to issues other than the fairness of the merger. It should also be noted that *Kohn's* concept of materiality is no longer valid, for in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 446, n. 8 (1976), this Court rejected the definition of materiality applied in *Kohn*.

Petitioner's challenge to the lower court's disposition of the materiality issue is also predicated upon a misreading of the *Mills* case and ignores the more recent holding in this Court in *TSC Industries, Inc. v. Northway, Inc., supra.* As noted, respondent McDonnell owned sufficient Conductron stock to permit it to effectuate the merger without the consent of any other shareholder. In accordance with Delaware law, the Consent Statement was sent for informational purposes only. In *Mills v. Electric Auto-Lite, supra*, at 385, this Court held that misstatements in proxy solicitation materials could be material only if the solicitation "was an *essential link* in the accomplishment of the transaction." This was further defined at page 386 of the Court's opinion as requiring the petitioners to establish their case "by showing that proxies *necessary to approval of the merger* were obtained by means of a materiality misleading solicitation . . ." (Emphasis added.)

The *Mills* opinion and common sense compel the conclusion that the *"essential link"* is tied to the requirement that the votes solicited be necessary to the approval of the transaction, and this reading was reaffirmed in *TSC Industries, Inc.* See also *Lewis v. Bogin*, 377 F.Supp. 331, 337 (S.D.N.Y. 1972). Hence, the federal claims here were properly dismissed for lack of causation.

CONCLUSION

For the reasons stated, the petition for Writ of Certiorari should be denied.

Respectfully submitted,

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